Fixer Upper: Buyer Deposits in Residential Real Estate Transactions

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"Penalties and forfeitures are not favored; and calling an outrageous penalty by the more kindly name of liquidated damages does not absolve it from its sin."[1]

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[1] Arthur L. Corbin, *The Right of a Defaulting Vendee to the Restitution of Instalments Paid*, 40 YALE L.J. 1013, 1016 (1931).

I. INTRODUCTION

You cannot turn on the television nowadays without being inundated by "property shows"—*House Hunters*, *Flip or Flop*, *Million Dollar Listing*, *Fixer Upper*, *Property Brothers*, *Love It or List It*, and so on. These shows are wildly popular. According to the *New York Times*, Home and Garden Television, HGTV, is "among the most popular [networks] on television, reaching 1.11 million views in May [2018 alone]."[2] It is rated fourth in prime time viewership, "meaning if you weren't watching Fox News, MSNBC or maybe 'Suits' on USA, there was a good chance you were tuned to HGTV."[3] These shows portray

[2] Ronda Kaysen, *For House Flippers, Reality Meets Reality TV*, N.Y. TIMES (June 15, 2018), https://www.nytimes.com/2018/06/15/realestate/for-house-flippers-reality-meets-reality-tv.html [https://perma.cc/6RQQ-ECKK].

[3] Jennifer Barger, *As Seen on TV: Home Makeover Shows Have Totally Upended Homeowners' Expectations*, WASH. POST (May 10, 2018), https://www.washingtonpost.com/realestate/as-seen-on-tv-many-homeowners-find-inspiration-in-home-makeover-programs/2018/05/09/38f754e8-4b1c-11e8-9072-f6d4bc32f223_story.html?noredirect=on&utm_term=.a114556cbb13 [https://perma.cc/23K2-A5LA] ("HGTV's widespread influence is not surprising: Since the network was launched on basic cable in 1994, its viewership has skyrocketed higher than offers in a North Arlington bungalow bidding war. According to the most recent Nielsen ratings, HGTV is the fourth-most-watched cable network in the United States, averaging more than 1.6 million viewers overall."); Ronda Kaysen, *Who Doesn't Love to Hate-Watch HGTV?*, N.Y. TIMES (Apr. 6, 2018), https://www.nytimes.com/2018/04/06/realestate/who-doesnt-love-to-hate-watch-hgtv.html [https://perma.cc/X9H8-X7B7].

the world of real estate as a rosy one: "the network's standard house-buying narrative involves a mythical couple with coveted mystery jobs who can sit down and buy a house like it's no big deal."[4] Everything gets resolved in half an hour—an hour, max—and the family lives happily ever after. The picture that these shows paint, though, is a far cry from the real world. In the real world, real estate contracting is not always a smooth process that culminates in buyers purchasing their dream house—one that is "perfect for entertaining"[5] and filled with must-haves like granite countertops, a farmhouse sink, and a shiplap-covered accent wall.[6]

In the real world, buyers sign contracts to purchase property, put down sizeable deposits, and then life circumstances intervene. A buyer may not be able to secure the mortgage financing they thought they could.[7] Or, a buyer may get sick, transferred for work, or divorced, making the purchase no longer a viable one.[8] Whatever the reason, buyers sometimes breach contracts to purchase real estate. In these circumstances, the common understanding is that buyers forfeit their deposit. This deposit is usually quite substantial, ranging from tens of thousands to hundreds of thousands of dollars (sometimes even millions of dollars).

Consider the following scenario: A buyer agrees to purchase a seller's home for $500,000, putting down $25,000 as an earnest money deposit. A month later, after contingencies have been removed, the buyer loses his job and is no longer able to afford the house. The buyer notifies the seller that he will not be proceeding with the transaction. The seller, in turn, re-lists the house and enters into a contract shortly thereafter to sell it for $550,000. The buyer asks for a return of his $25,000 earnest money deposit, but the seller refuses. Is the seller entitled to keep the $25,000 even though he has suffered no losses—and actually ended up better off as a result of the buyer's breach? Probably. This scenario is

[4] Kate Wagner, *We Need a New Kind of HGTV*, CURBED (May 30, 2018), https://www.curbed.com/2018/5/30/17390302/hgtv-fixer-upper-renovation-shows-house-hunters [https://perma.cc/4Y66-YGAL].

[5] Anybody who has watched any property show knows that a home "perfect for entertaining" is very high on almost any homebuyer's list.

[6] Farmhouse sinks and shiplap have been made popular through the wildly successful show, *Fixer Upper*. *See* Barger, *supra* note 3 ("'We have started getting more requests for shiplap,' says Bill Millholland, an executive vice president at [a] remodeling firm . . . , referring to the grooved, interlocking wooden boards that 'Fixer Upper' hosts Chip and Joanna Gaines use to add rustic flair to everything from kitchen islands to bedroom ceilings."); Lisa Johnson Mandell, *Farmhouse Chic: 10 Hot Home Decor Tricks from Chip and Joanna Gaine*s, REALTOR.COM (Oct. 23, 2017), https://www.realtor.com/advice/home-improvement/farmhouse-chic-home-decor-tips/ [https://perma.cc/SY5L-HCZP]. In a recent *New York Times* article, the author muses, "In an era of political uncertainty, turmoil and real-life cliffhangers, who doesn't want to escape to an alternate universe where, with the right blend of shiplap and granite, you could achieve perfection in your home, and by extension, your life?" Kaysen, *supra* note 3.

[7] *See infra* Part III.

[8] *See infra* Part III.

not just a hypothetical. Real buyers have lost real money when they have walked away from a contract, often because life circumstances conspired against them.[9] Meanwhile, many sellers have made a handsome profit by retaining a buyer's deposit and reselling the property for a considerable gain.[10]

Many—if not, most—courts have upheld the forfeiture of a buyer's deposit even where the seller suffered no actual harm. Courts generally see a buyer's deposit as a form of liquidated damages to be paid by the buyer in the event of a breach, irrespective of actual losses. There seems to be very little sympathy in the case law for buyers who are out huge sums of money,[11] and much indignation on behalf of sellers who are, after all, the innocent party that *could have* suffered immeasurable damage as a result of the buyer's breach. In requiring buyers to surrender their deposits, courts often tout the advantages of liquidated damages clauses, the certainty that they provide, and the importance of holding parties to their bargain.[12] What they fail to recognize is that there is a profound disconnect between the theory behind liquidated damages and the reality of real estate contracting.

Liquidated damages are intended to represent the parties' attempt to forecast potential harm and provide a sum of money that would compensate the injured party for that harm.[13] In actuality, the deposit amount in a contract to purchase real estate bears no relationship to the harm that a seller might suffer in the event of a buyer's breach. The deposit number is largely chosen at random and based

[9] A *New York Times* article from 2009 describes the plight of buyers who have lost in the neighborhood of $100,000 (or more) when they defaulted on contracts to purchase real estate. *See* Vivian S. Toy, *Up in Smoke: The Deposit Vanishes*, N.Y. TIMES (Mar. 20, 2009), https://www.nytimes.com/2009/03/22/realestate/22cov.html [https://perma.cc/9H2L-EN66]. One couple forfeited a deposit of $93,199, their entire savings, on a two-bedroom apartment priced at $956,990. *Id.* Another forfeited a $173,000 deposit on a $1.73 million apartment when mortgage brokers informed them that the financing they thought they secured no longer existed. *Id.* One woman signed a contract to purchase a $1.4 million apartment where she was required to put down a 20% deposit originally, and then was asked to come up with an extra $140,000 to secure financing. *Id.* When she could not do so, she forfeited the 20% deposit. *Id.* The article shows people being forced to walk away from their life savings with almost no way for them to get back their deposits. *Id.*; *see also* Christopher Flavelle, *Money Down, Money Gone*, N.Y. TIMES (Mar. 21, 2009), https://www.nytimes.com/video/realestate/1194838800406/money-down-money-gone.html [https://perma.cc/U7TC-NXWJ] (featuring a video of New York City delicatessen owner, Louis Andriopoulos, explaining how he lost a sizeable deposit in a real estate transaction).

[10] *See* Karimi v. 401 N. Wabash Venture, 952 N.E.2d 1278, 1282–88 (Ill. App. Ct. 2011) (buyer forfeited nearly $330,000 even though seller made over $400,000 profit on the resale of the property).

[11] *See, e.g.*, Bellon v. Acosta, 10 So. 3d 1165, 1166–68 (Fla. Dist. Ct. App. 2009) (buyers cancelled contract five days after the agreed-upon contingency date; court ordered forfeiture of the $100,000 deposit).

[12] *See id.*; *see also Karimi*, 952 N.E.2d at 1287 ("[Buyers] had knowledge of and agreed to the amounts included as liquidated damages at the time of contracting . . . .").

[13] *See infra* Part II.

on the standard practice in that particular real estate market.[14] In fact, in hot markets, the deposit amount is likely to be higher than normal so that the buyer can secure the property.[15] Yet, in a hot market, the seller is the least likely to suffer any harm in the event of a buyer's breach.

The issue of whether (or when) a seller should be able to keep a buyer's deposit in a residential real estate transaction is curiously unexplored in the academic commentary.[16] It is unclear why more is not written on the topic, given that over six million homes were sold in 2018 alone,[17] and the dollar volume of those transactions likely exceeded one trillion dollars.[18] There are a couple of possible reasons for the absence of academic commentary on the topic of buyer deposits in residential real estate transactions. First, it is widely accepted that if a buyer breaches a contract to purchase real estate, he will forfeit his deposit. The propriety of this "rule" is rarely questioned. So, what is the point of exploring a principle that is firmly entrenched in law? Second, residential real estate is one of the least theoretical topics in the law. It is the bread and butter stuff that "real lawyers" do, but not usually the sort of topic that academics give much thought to.

This Article seeks to bridge the gap between the practical and the theoretical. It argues that we need to pay more attention to the reality of residential real estate contracting and, in particular, to clauses that require a buyer to forfeit his deposit in a failed real estate transaction. Buyers often lose large amounts of money when they breach a contract—money that does not correspond to a seller's losses. Courts are more than willing to uphold liquidated damages clauses that punish a buyer for breaching a contract, without regard to the reasonableness of the clause, or to whether the clause was intended to compensate for potential harm. It is time to see deposits in residential real estate contracts as a consumer protection issue. The law must rein in "party autonomy" in order to provide a more equitable balancing of all the interests involved.

[14] *See infra* Part III.

[15] *See infra* Part III.

[16] *But see* Jeffrey B. Coopersmith, Note, *Refocusing Liquidated Damages Law for Real Estate Contracts: Returning to the Historical Roots of the Penalty Doctrine*, 39 EMORY L.J. 267 (1990) (student note examining deposits in real estate transactions); James Arthur Weisfield, Note, *"Keep the Change!": A Critique of the No Actual Injury Defense to Liquidated Damages*, 65 WASH. L. REV. 977 (1990) (student note commenting on Washington State's "no actual injury" defense to the enforcement of liquidated damages clauses in real estate contracts).

[17] *Quick Real Estate Statistics*, NAT'L ASS'N REALTORS (May 11, 2018), https://www.nar.realtor/research-and-statistics/quick-real-estate-statistics [https://perma.cc/ZYG7-XRJD] ("5.34 million existing homes were sold in 2018, according to data from the National Association of Realtors. 667,000 newly constructed homes were sold in 2018, according to the U.S. Census Bureau.").

[18] Panle Jia Barwick et al., *Conflicts of Interest and Steering in Residential Brokerage*, 9 AM. ECON. J.: APPLIED ECON. 191, 191 (2017) ("In 2014, there were 4.94 million existing home sales valued in aggregate at $1.26 trillion dollars . . . ."). It stands to reason that the dollar value of the transactions four years later, in 2018, also exceeded $1 trillion dollars.

This Article proceeds as follows: In Part II, I discuss liquidated damages in general to set the backdrop for the discussion that follows. In Part III, I analyze clauses that require a buyer to forfeit his deposit in contracts to purchase real estate as a form of liquidated damages. Further, I explore the attendant doctrinal difficulties in the application of the tests that courts use to ascertain whether these clauses are enforceable. In Part IV, I look at case law concerning deposit/liquidated damages clauses and make note of some general trends: the widespread enforceability of liquidated damages clauses in the real estate context; the rubber-stamping of such clauses with little to no legal analysis; the rhetoric of "uncertainty" used to bolster liquidated damages clauses; and the inflating of damages to justify the enforceability of liquidated damages clauses. From there, I situate the discussion of deposits in the larger context of real estate contracting. In Part V, I examine closely the reality of real estate contracting, which, in turn, calls into question many of the assumptions underpinning the enforceability of liquidated damages clauses. In Part VI, I posit that deposits in real estate transactions should be viewed as a consumer protection issue, necessitating statutory intervention. This sets the stage for Part VII, where I formulate a draft "Deposit Statute" specific to the residential real estate context. Finally, in Part VIII, I offer some concluding remarks.

II. A BRIEF PRIMER ON LIQUIDATED DAMAGES

Liquidated damages, also known as "stipulated" or "agreed" damages, are damages that the parties agree to in advance as the amount of money that a breaching party will pay an innocent party in the event of a breach.[19] If a contract is breached, the innocent party is entitled to the stipulated sum in lieu of a judgment for actual damages.[20] Liquidated damages clauses can take a variety of forms, from a designated lump sum, to a mathematical formula, to anything in between.[21] The key, though, is that the clause represents an attempt by the parties to set their own damages ahead of time in the event of a potential breach.[22]

Various justifications exist for enforcing liquidated damages clauses. First, it is thought that liquidated damages are an expression of party autonomy, and that courts should give effect to the will of the parties.[23] Under this view,

[19] Ann Morales Olazábal, *Formal and Operative Rules in Overliquidation Per Se Cases*, 41 AM. BUS. L.J. 503, 510 (2004) ("An agreed, stipulated, or liquidated damages clause in a contract represents the contracting parties' agreement, in advance of any breach, as to the amount of damages that the breaching party will pay to the nonbreaching party in the event of future default or breach of the contract.").

[20] *See id.* at 510–11.

[21] *See id.* at 511 (discussing the numerous forms liquidated damages may take).

[22] *Id.* ("Regardless of the form they take, parties typically agree to these clauses in an effort to avoid the need for proof of damages in an ultimate breach of contract action.").

[23] *See* Coopersmith, *supra* note 16, at 285 ("The parties themselves are best positioned to determine the value of performance or breach, both subjectively and objectively. Thus, a

liquidated damages clauses are no different than other clauses in a contract, and courts should routinely enforce them.[24] Second, enforcing liquidated damages clauses provides certainty to the parties about where they stand; they know, "If I default on this contract, I will owe $x." This certainty allows parties to plan their affairs accordingly.[25] Third, liquidated damages clauses allow parties to mitigate risk. A party may prefer to agree in advance to pay, say $20,000, than run the risk of owing actual damages in an amount far exceeding $20,000.[26] Fourth, the routine enforcement of liquidated damages clauses cuts back on litigation (at least in theory), saving time and expense for both the parties and the courts.[27]

While parties are free to liquidate damages, they are not free to impose a penalty for breach of contract.[28] That is, liquidated damages are intended to be compensatory—not punitive—in nature.[29] The *Restatement (Second) of*

fairly negotiated liquidated damages clause has the advantage of taking into account subjective aspects of risk and damages far better than the courts.").

[24] Michael Pressman, *The Two-Contract Approach to Liquidated Damages: A New Framework for Exploring the Penalty Clause Debate*, 7 VA. L. & BUS. REV. 651, 653 (2013) ("The common understanding of liquidated damages provisions . . . is that they are simply one of many clauses in a contract. In arguing for our freedom to contract about remedial terms, Richard Epstein writes: 'Damage rules are no different from any other terms of a contract. They should be understood solely as default provisions subject to variation by contract.' While perhaps remedial provisions are written with respect to a particular eventuality, Epstein sees these clauses as components of the contract.").

[25] *See* Weisfield, *supra* note 16, at 978 ("Allowing parties to predetermine the remedies for a broken promise enables them to allocate business risks during contract formation. First, by negotiating the amount at which to fix damages, parties learn the nature and range of harm a breach might cause, thus enabling them to weigh the gains from performance against the costs of breach.").

[26] The certainty and risk rationales are inherently intertwined. *See* Coopersmith, *supra* note 16, at 283–84 ("A primary goal of such clauses is to control risk. The buyer is willing to stipulate damages so that he will be liable for no more than the agreed amount, while the seller is ensuring that the buyer will be liable for no less. Rather than roll the juridical dice, the parties to the contract are willing to pay a price for certainty. In essence, the liquidated damages clause may be thought of as a form of insurance. The parties are willing to agree to a set price today so that they may avoid potentially greater losses tomorrow. Thus, even if the buyer ultimately pays despite no actual damages, the buyer has received what he has bargained for: *certainty* itself.").

[27] *Id.* at 285 ("A further purpose of liquidated damages clauses is avoidance of the litigation process altogether. General enforcement of such clauses would avoid much litigation between commercial entities . . . , encourage the settlement of disputes, and further the goal of reducing court congestion."); Weisfield, *supra* note 16, at 979–80 ("Liberal enforcement also promotes more efficient dispute resolution. First, valid liquidated damages clauses save parties the expense and delay of preparing for and litigating complicated damages issues, and save the time of judges, juries and witnesses. Second, favoring liquidated damages clauses increases the likelihood of pretrial settlements.").

[28] For a brief history of the penalty doctrine, see Olazábal, *supra* note 19, at 511–14.

[29] 22 AM. JUR. 2D *Damages* § 507, at 468–69 (2013) ("Where parties stipulate as to the amount of damages due in the event of contractual breach, and the stipulation is not based upon contemplated actual damages but is intended to provide punishment for breach of the

Contracts provides that "[t]he parties to a contract may effectively provide in advance the damages that are to be payable in the event of breach as long as the provision does not disregard the principle of compensation. However, the parties to a contract are not free to provide a penalty for its breach."[30] Thus, if the purpose (or effect) of a liquidated damages clause is to compel performance or deter breach, the clause will be considered an unenforceable penalty. In such cases, the aggrieved party will have to prove his damages according to normal contract principles.[31]

The difficult question, of course, is how to determine whether a given clause constitutes a reasonable liquidated damages clause or an unenforceable penalty.[32] Courts generally consider the following three factors in determining whether or not to enforce a liquidated damages clause:[33] (a) Uncertainty. Are the damages caused by the breach uncertain and/or difficult to accurately estimate? (b) Intention. Did the parties intend to liquidate damages or did they intend to impose a penalty?[34] (c) Reasonableness. Is the sum stipulated a

contract, it is a 'penalty'; where parties stipulate as to the amount of damages due in the event of contractual breach, and the stipulation is reasonably intended by the parties as the predetermined measure of compensation for actual damages that might be sustained by reason of nonperformance, the stipulation is for 'liquidated damages.'").

[30] RESTATEMENT (SECOND) OF CONTRACTS § 356 cmt. a (AM. LAW INST. 1981).

[31] *See id.* § 347 ("Subject to the limitations stated in §§ 350–53, the injured party has a right to damages based on his expectation interest as measured by (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform." (alterations in formatting)).

[32] Dean V. Kruse Found., Inc. v. Gates, 973 N.E.2d 583, 592 (Ind. App. Ct. 2012) ("However, despite the plethora of abstract tests and criteria for the determination of whether a provision is one for a penalty or liquidated damages, there are no hard and fast guidelines to follow.").

[33] *See, e.g.*, Ravenstar, LLC v. One Ski Hill Place, LLC, 401 P.3d 552, 555 (Colo. 2017) ("A liquidated damages provision is valid and enforceable if three elements are met: (1) 'the parties intended to liquidate damages'; (2) 'the amount of liquidated damages, when viewed as of the time the contract was made, was a reasonable estimate of the presumed actual damages that the breach would cause'; and (3) 'when viewed again as of the date of the contract, it was difficult to ascertain the amount of actual damages that would result from a breach.'"); Tsiropoulos v. Radigan, 133 A.3d 898, 903 (Conn. App. Ct. 2016) ("Accordingly, such a provision is ordinarily to be construed as one for liquidated damages if three conditions are satisfied: (1) The damage which was to be expected as a result of the breach of the contract was uncertain in amount or difficult to prove; (2) there was an intent on the part of the parties to liquidate damages in advance; and (3) the amount stipulated was reasonable in the sense that it was not greatly disproportionate to the amount of the damage which, as the parties looked forward, seemed to be the presumable loss which would be sustained by the contractee in the event of a breach of the contract.").

[34] The *Restatement (Second) of Contracts* omits reference to the parties' intentions. Section 356 provides:

> (1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by

reasonable approximation of harm? Stating the test is easy; applying it is another thing altogether.[35] Courts struggle with applying this three-part test generally, but, as discussed in more detail below, the problems are particularly acute in the real estate context.

III. DEPOSITS AS LIQUIDATED DAMAGES IN REAL ESTATE TRANSACTIONS

A. *General Background*

Typically, when parties reach an agreement to buy and sell residential real estate, the buyer will put down a sum of money as a deposit, also known as an earnest money deposit. As its name indicates, the purpose of the earnest money deposit is for the buyer to show the seller that he is "earnest" (i.e., serious) about the transaction.[36] The amount of the deposit varies considerably from jurisdiction to jurisdiction, but customarily ranges from 1% to 10% of the purchase price.[37] In some states, the deposit amounts are even higher—up to

> the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.

RESTATEMENT (SECOND) OF CONTRACTS § 356 (AM. LAW INST. 1981). Some authors suggest that there are actually only two parts to the analysis. *See* Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 225 (1995) ("Liquidated damages provisions are enforceable if but only if two conditions are satisfied: (I) Actual damages are difficult to estimate; and (II) the amount fixed in the provision is a reasonable estimate of the actual loss."); Olazábal, *supra* note 19, at 513 ("Generally speaking, the law asks two questions. First, are the expected damages of the type that (or is the transaction of the type that would result in damages that) will be difficult to ascertain? And second, is the stipulated sum reasonable?").

[35] Some courts approach the analysis differently. For instance, Florida courts usually focus on whether the liquidated damages clause is unconscionable, a much higher standard than "unreasonable." *See* Beatty v. Flannery, 49 So. 2d 81, 82 (Fla. 1950); Johnson v. Wortzel, 517 So. 2d 42, 43 (Fla. Dist. Ct. App. 1987). Under this approach, liquidated damages clauses in the neighborhood of 20% of the purchase price have been upheld. *See Johnson*, 517 So. 2d at 43 ("We do not find that [the seller] has been unjustly enriched in retaining items of consideration determined by the trial court to amount to $347,011.66, as compared to a total purchase price of $1,900,000. The amount forfeited by the buyers represents 18.2% of the total contract, a percentage that is not sufficient to shock the conscience of the court."); Bloom v. Chandler, 530 So. 2d 341, 341 (Fla. Dist. Ct. App. 1988) (allowing sellers to retain $49,500 deposit on a $225,000 property transaction, or 22% of the purchase price).

[36] Brandon Cornett, *How Much Earnest Money Should I Put Down on a House?*, HOME BUYING INST. (2018), http://www.homebuyinginstitute.com/mortgage/how-much-earnest-money-to-pay/ [https://perma.cc/FPN8-GM9Q] ("The earnest money deposit is a way for the buyer to say, 'I am sincere about purchasing this home, and I'm not trying to waste your time.'").

[37] *See* David K. Kertzman & Robert B. Carpenter, *Residential Real Estate Law, Massachusetts Style*, *in* INSIDE THE MINDS: REPRESENTING CONSUMERS IN MASSACHUSETTS REAL ESTATE TRANSACTIONS 23, 29 (2015) ("Default typically means loss of the deposit made when the offer and purchase and sale agreement were signed, which is typically from

20% of the purchase price.[38] The deposit is usually held by either the seller's realtor or an escrow agent until closing,[39] where the deposit is then credited toward the purchase price.

Most residential real estate transactions allow for certain buyer contingencies, whereby the buyer may cancel the contract if the contingencies are not satisfied.[40] For instance, the contract may provide that it is contingent upon the property appraising for at least the purchase price.[41] If the appraisal is not satisfactory, the buyer has the right to walk away and to recover his deposit.[42] However, once the contingencies are "removed," the buyer is obligated to proceed with the transaction, or risks being in default or breach of contract.[43]

There are a variety of reasons why a buyer may breach a contract to purchase residential real estate. The buyer may have had a change in personal circumstances (job, family, illness, financial) that makes the purchase no longer

5 percent to 10 percent of the purchase price . . . ."); *What Is Earnest Money?*, REAL GROUP REAL EST. (Apr. 9, 2018), https://www.realgroupre.com/blog/196-what-is-earnest-money.html [https://perma.cc/6ZRQ-TS2Z] ("[E]arnest money is a sign of good faith . . . which could range anywhere between 3–10% of the contract price."); Margaret Heidenry, *8 Earnest-Money Deposit Mistakes Home Buyers Live to Regret*, REALTOR.COM (Feb. 21, 2017), https://www.realtor.com/advice/finance/earnest-money-deposit-mistakes-buyers-make/ [https://perma.cc/NE38-6A4Y] ("The amount of earnest money is negotiable between the buyer and seller, but is usually about 1% to 2% of the purchase price (although it can shoot up to 10%)."); James Chen, *Earnest Money*, INVESTOPEDIA (Feb. 12, 2019), https://www.investopedia.com/terms/e/earnest-money.asp [https://perma.cc/LB6M-KKL9] ("In hot housing markets, the earnest money deposit might range between 5% and 10% of a property's sale price.").

[38] *See supra* note 35 (discussing Florida law); *see also* Edlow v. RBW, LLC, 688 F.3d 26, 38–39 (1st Cir. 2012) (finding a 20% deposit not so unconscionably excessive as to constitute an unenforceable penalty).

[39] "Closing" is a term used to describe "the time when [an] executory real estate contract becomes fully executed, *i.e.* [sic] the consideration is paid by the buyer and the deed is delivered by the seller." Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn from Residential Real Estate Conveyancing*, 62 MO. L. REV. 241, 245 n.16 (1997). Closing is also sometimes known as "settlement." *Id.*

[40] Margaret Heidenry, *Earnest Money Deposit: How Home Sellers Can Keep It Fair and Square*, REALTOR.COM (Feb. 17, 2017), https://www.realtor.com/advice/sell/earnest-money-deposit-home-sellers-keep-it/ [https://perma.cc/A75Z-XDJ9] ("Typical contingencies include the following: Funding: A buyer gets his earnest money deposit back if his mortgage falls through. Condition: If undisclosed problems with the property are discovered by a home inspection, the buyer can generally back out with no penalty. Title search: A buyer can usually void a contract if a title search comes back with a lien or issues with the ownership of a property. Sellers can do a title search before listing to clear up any red flags. Appraisal: When a property doesn't appraise for the sale price, a buyer can walk away.").

[41] *Id.*

[42] *Id.*

[43] "Default" and "breach of contract" are used synonymously.

a feasible option.[44] Or, the buyer may have removed contingencies, such as a mortgage contingency, without fully securing financing.[45] Or, the buyer may have realized that the purchase was not a wise one and that he does not want to go through with it.[46] Or, the buyer may have a genuine belief that he is entitled

[44] *See, e.g.*, Zachar v. Lee, 363 F.3d 70, 72 (1st Cir. 2004) ("Like the setting sun . . . [the buyer's] desire to purchase the Property [on Nantucket] began fading to the west when [the buyer] accepted a job as a telecommunications stock analyst in San Francisco."); Willert v. Russo, No. CV075002983, 2009 WL 1532376, at *2 (Conn. Super. Ct. May 4, 2009) ("The anticipation of septic repair expense and lack of any interest by prospective purchasers in a weakening real estate market, accompanied by their older daughter's engagement announcement caused the defendants to make the decision to withdraw from the purchase of plaintiff's property . . . ."); Paez v. Coleman-Toll Ltd., 281 P.3d 1207, 1207 (Nev. 2009) ("[Buyer defaulted] because he was unemployed, was separating from his wife, and had insufficient assets to purchase the property."); Malus v. Hager, 712 A.2d 238, 239 (N.J. Super. Ct. App. Div. 1998) ("The closing was scheduled to take place on July 15, 1996. On July 11, 1996, [the buyer] was terminated, not for cause, from his employment. . . . In light of [the buyer's] loss of employment, [the lender] exercised its rights under that reservation and declined to fund the mortgage.").

[45] *See, e.g.*, Reply Brief of Appellant at 4, Tsiropoulos v. Radigan, 133 A.3d 898 (Conn. App. Ct. 2016) (No. 37176) ("The Plaintiff, relying on the advice of several professional mortgage brokers and mortgage lenders, agreed in the Contract to waive any financing contingency. . . . Contrary to initial representations, the Plaintiff was ultimately unable to obtain financing with Wells Fargo when he was informed that he would have to liquidate certain business assets outside of his immediate control." (internal citations omitted)). Sometimes real estate agents convince their buyers to put in an offer with no contingencies in order to secure the property. *See* Benny L. Kass, *Big Deposit, No Mortgage Deal: Serious Trouble*, WASH. POST (June 12, 2004), https://www.washingtonpost.com/archive/realestate/2004/06/12/big-deposit-no-mortgage-deal-serious-trouble/26bad715-ddc2-4119-b80b-2343b2a35365/?utm_term=.f2d766d7e0c6 [https://perma.cc/GPY4-F4Y5] ("Q[uestion:] I think we are in trouble. Three weeks ago, we signed a contract to buy a single-family house. Our real estate broker told us that there was a lot of interest in the property and that if we really wanted to buy we should not put any contingencies into our contract offer. We thought that we could qualify for a mortgage, and took the broker's advice. It now turns out that our credit score is too low and our mortgage lender has turned us down. We put up a $20,000 earnest-money deposit, and are now concerned that we may lose this money—as well as the house—if we are unable to get a loan. . . . A[nswer:] Yes, you may be in serious trouble . . . ."). Waiving financing contingencies is not uncommon, especially in competitive markets. *See* Leigh Kamping-Carder, *The Strangely Effective (and Easy) Way to Win a Bidding War*, WALL ST. J. (Jan. 18, 2018), https://www.wsj.com/articles/the-strangely-effective-and-easy-way-to-win-a-bidding-war-1516280661 [on file with *Ohio State Law Journal*].

[46] *See, e.g.*, Julien Gignac, *Couple Ordered to Pay $470,000 After Reneging on Ontario Home Deal*, TORONTO STAR (Apr. 15, 2018), https://www.thestar.com/news/gta/2018/04/11/couple-ordered-to-pay-470000-after-reneging-on-stouffville-home-deal.html [https://perma.cc/DF2V-B9BV] (reporting that a couple realized that they had overextended themselves by purchasing property and tried to withdraw from the transaction several days after signing purchase and sale agreement; court ordered that they pay almost half a million dollars in damages to seller).

to cancel the transaction.[47] Whatever the reason, "stuff happens," and buyers are not always able or willing to go through with the transaction.[48]

The purchase and sale agreement will usually provide that the deposit amount constitutes liquidated damages to be retained by the seller in the event of the buyer's default. For instance, the Standard Residential Purchase and Sale Agreement endorsed by the Massachusetts Association of Realtors states:

> If the Buyer . . . breaches this Agreement, all escrowed funds paid or deposited by the Buyer shall be paid to the Seller as liquidated damages . . . . The Buyer and Seller agree that in the event of default by the Buyer the amount of damages suffered by the Seller will not be easy to ascertain with certainty and, therefore, Buyer and Seller agree that the amount of the Buyer's deposit represents a reasonable estimate of the damages likely to be suffered.[49]

Occasionally, the contract will not specifically reference liquidated damages, but instead will simply say that the seller will "retain" or "keep" the deposit in the event of a breach, or that the buyer will "forfeit" the deposit in the event of a breach.[50] For instance, the Single Family Purchase and Sales

[47] *See, e.g.*, Peterson v. McAndrew, 125 A.3d 241, 251 (Conn. App. Ct. 2015) ("[The court] first determined that the plaintiff's breach was not willful. The court expressly noted in the present case that the plaintiff's subjective fear that he would not own waterfront property after the closing was not legally justified, but, nonetheless, was genuine.").

[48] Sometimes the breach may occur due to circumstances entirely beyond the buyer's control. For instance, in Ivanov v. Sobel, 654 So. 2d 991, 992 (Fla. Dist. Ct. App. 1995), the broker's salesperson absconded with all of the money that had been earmarked by the buyers to complete the real estate purchase. As a result of losing hundreds of thousands of dollars, the buyers were not able to close. *Id.* The court nonetheless found the buyers to be in breach and ordered that they forfeit their $30,000 earnest money deposit. *Id.* at 992–93.

[49] MASS. ASS'N OF REALTORS, STANDARD RESIDENTIAL PURCHASE AND SALE AGREEMENT [#503] 5, http://www.amortgage.com/xSites/Mortgage/AlexanderMortgageCorp/Content/UploadedFiles/P%20and%20S%20Residential.pdf [https://perma.cc/USQ4-3HVN]; *see also* E. CONN. ASS'N OF REALTORS, PURCHASE AND SALE AGREEMENT 2, http://www.easternctrealtors.com/assets/files/ecarTraining/Purchase%20&%20Sales%20Revised%2091808.pdf [https://perma.cc/YJX6-FQHL] ("[On] Buyer Default . . . Seller retain[s] the deposit money as liquidated damages . . . ."); FLA. ASS'N OF REALTORS, RESIDENTIAL SALE AND PURCHASE CONTRACT 4, http://www.unlimitedmls.com/forms/FAR-Residential-Sale-and-Purchase-Contract.pdf [https://perma.cc/HXD8-ESPZ] ("If Buyer fails to perform this Contract . . . Seller may choose to retain and collect all deposits paid and agreed to be paid as liquidated damages . . . .").

[50] If the contract does not expressly provide for the buyer to forfeit the deposit, or for the sum to be treated as liquidated damages, courts may view the deposit as simply providing partial payment for any actual damages suffered. *See* Coopersmith, *supra* note 16, at 270 ("Depending on the language used in the contract and the discernible intent of the parties, the existence of an earnest money provision in a real estate sales contract . . . could be considered as partial payment of any actual damages which can be proven as the result of the buyer's breach."). *But see* Berlin & Denmar Distribs. v. Goldstein Dev. Corp. (*In re* Berlin & Denmar Distributors), No. 10-15519, 2014 WL 2178027, at *5 (Bankr. S.D.N.Y. May 23, 2014) ("Under New York law, and with certain exceptions . . . a prospective

Agreement used by the Rhode Island Association of Realtors provides: "Upon default by the Buyer, Seller shall have the right to retain the Deposits . . . ."[51]

Whether the contract expressly provides that the deposit constitutes liquidated damages, or simply allows the seller to retain the deposit upon breach usually does not impact the legal analysis.[52] That is, most (though not all) courts recognize that a clause providing that the seller will retain the deposit is really just a disguised liquidated damages clause.[53] Accordingly, courts will usually apply some version of the three-part liquidated damages test—uncertainty, party intentions, and reasonableness—to determine whether or not to allow a seller to retain a deposit when a buyer defaults in a real estate transaction.

B. *The Test for Liquidated Damages*

A look at the case law reveals that courts are all over the map when it comes to applying the three-part test for liquidated damages, leading to confusion and inconsistency in the treatment of real estate deposits. This is because "many of the formulations [of the test for liquidated damages] are profoundly ambiguous."[54]

The first prong of the liquidated damages test involves asking whether damages are uncertain and/or difficult to ascertain. It is unclear exactly what must be uncertain or difficult to ascertain.[55] One view is that the harm itself must

purchaser who defaults on a real estate contract without lawful excuse forfeits his deposit, even where the contract does not contain a forfeiture clause." (emphasis omitted)).

[51] R.I. ASS'N OF REALTORS, SINGLE FAMILY PURCHASE AND SALES AGREEMENT 5 (2006), http://www.topproducerwebsite.com/users/21527/downloads/Single%20Family%20P&S.pdf [https://perma.cc/L4LZ-R382].

[52] *See, e.g.*, Berggren v. Hill, 928 N.E.2d 1225, 1229 (Ill. App. Ct. 2010) ("In the absence of an express provision to the contrary, a provision for the forfeiture of earnest money will be construed as a liquidated damages clause."). Sometimes, the clause will simply provide that the buyer deposit $x in earnest money, with no express reference to forfeiture. *See, e.g.*, Ner Tamid Congregation of N. Town v. Krivoruchko, No. 08 C 1261, 2010 WL 391611, at *4 (N.D. Ill. Feb. 3, 2010) ("The contract merely provided that the required earnest money deposit of $150,000 would be held by the Escrowee . . . . The real estate sales contract is silent on the question of what happens to the escrowed funds in the event of a breach by the purchaser. Is [seller] entitled to that sum as liquidated damages? The contract does not say. Indeed, the contract does not use the term 'liquidated damages' at all. It merely says that the $150,000 is to be credited towards the purchase price at closing.").

[53] GARY L. MONSERUD, THE LAW OF LIQUIDATED DAMAGES IN MASSACHUSETTS § 5.3 (1st ed. 2013) ("During the era when deposits were first analyzed under the law of liquidated damages, there arose a parallel line of authorities allowing aggrieved sellers in real estate cases to retain deposits without any consideration of whether or not the parties intended to liquidate damages. This was the law of forfeiture which had two branches: there was consensual forfeiture based upon agreement of the contracting parties, and nonconsensual forfeiture allowed by law with no inquiry into the parties' intentions.").

[54] Eisenberg, *supra* note 34, at 225.

[55] Olazábal, *supra* note 19, at 515 n.57 ("Depending on whether a court reviews the agreed damages clause from the perspective of the time of contracting, the time of breach,

be "one that is incapable or very difficult of accurate estimation."[56] For instance, Professor Corbin suggests liquidated damages clauses are appropriate in situations where difficulties of proof make it "impossible by mathematical processes or by the use of established market prices [to provide a] definite standard of valuation."[57] Thus, in cases where it is difficult to "put a price" on breach, liquidated damages clauses are used to enable the parties to place their own valuations on performance and breach.[58] Another approach, however, looks at whether the amount of harm that will occur in the event of a breach is difficult to forecast. That is, rather than focusing on whether the harm is of a *type* that is not easily quantifiable in money terms, this approach looks at whether the *amount* of damages is difficult to predict in advance.[59] Typically, courts focus on the latter inquiry in the context of real estate contracts.[60]

Adding to the complexity is the fact that it is unclear when such uncertainty is measured: at the time of contracting, or at the time of trial. That is, do damages have to be difficult to predict as of the time of contracting? Or, do damages have to be difficult to ascertain as of the time of trial? There are problems with both views. If damages must be uncertain at the time of contracting, this would seem to validate all liquidated damages clauses in the context of real estate transactions. This is because real estate markets fluctuate, making it impossible to determine damages with certainty ahead of time in the event of a breach.[61]

or the time of trial, this requirement can incorporate a number of different considerations, including difficulty of proving damages at trial, difficulty of determining what damages the breach actually caused, difficulty of ascertaining the damages the parties contemplated at the time of contracting, absence of a standardized measure of damages for breach, and the difficulty of forecasting, when the contract is made, all of the possible damages that might be occasioned by various possible breaches.").

[56] RESTATEMENT (FIRST) OF CONTRACTS § 339(1)(b) (AM. LAW INST. 1932).

[57] Olazábal, *supra* note 19, at 515 (citing 5 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS: A COMPREHENSIVE TREATISE ON THE WORKING RULES OF CONTRACT LAW § 1060 (1964)).

[58] *See id.* at 515–16 ("By way of example, damage stipulations are commonly found in construction contracts. A typical clause in this context might call for payment of a set amount of money per diem beyond a promised completion date. Without such a provision in the construction contract, a general contractor delayed by a subcontractor's failure timely to perform his subcontract would need to prove the exact contract damages that flowed from the sub's delay, and usually at least some of these damages are difficult to quantify. Accordingly, as a general rule losses resulting from so-called 'construction contractor delay' are thought to be of the type that eludes precision of proof (i.e., are 'unascertainable').").

[59] Weisfield, *supra* note 16, at 983–84 ("Courts often hold that uncertainty requires that neither contract law nor the agreement furnish a formula for computing damages. Alternatively, regardless of whether a damages formula exists, some courts find uncertainty where the precise amount or extent of damages is difficult to ascertain or prove.").

[60] Note that there are innumerable iterations of the "uncertainty" prong of the liquidated damages test. For instance, Weisfield points out that there are four versions of the uncertainty test under Washington state law. *Id.* at 983 n.32.

[61] *See* Li v. Yaggi, No. CV145034810S, 2017 WL 3879260, at *8 (Conn. Super. Ct. July 25, 2017) ("[S]uperior courts have held that an action 'which involves a real estate contract where the seller is faced with the re-listing of a property after default has been found

One author argues that parties can rarely "predetermine precisely or within a narrow range the amount of damages that would flow from breach" and that "[u]npredictable market fluctuations and variations in the severity of possible breaches make ascertaining the amount of potential damages nearly impossible."[62] Thus, if uncertainty of damages is measured as of the time of contract formation, this requirement becomes entirely superfluous.

Conversely, if damages must be uncertain at the time of the trial,[63] then liquidated damages clauses would almost never be upheld. This is because:

> Actual damages can always be proven at trial [since] either the property has been resold or expert testimony can reconstruct the market at the date of the breach. "So never, except in the case where actual damage roughly equates the liquidated damages as shown by subsequent events, could there be a good liquidated damages clause . . . ."[64]

Consequently, looking at whether damages are uncertain at the time of trial will likely cause courts to invalidate many liquidated damages clauses.[65] In the words of one court, "if this approach were adopted, a real estate contract could never contain an enforceable liquidated damages clause."[66] Courts will use one view or the other to justify their conclusion either upholding, or refusing to uphold, a liquidated damages clause, usually not even recognizing the inherent ambiguity in the analysis.[67]

to satisfy the criteria of uncertainty . . . . [T]here are many variables that will be affected by the failure to satisfy the terms of a real estate purchase . . . [c]osts of carrying, maintaining, insuring and protecting the property; loss of interest income on the proceeds, loss of optimum market time, value and additional commissions, fees, taxes and borrowing expenses to meet obligations entered into in anticipation of performance . . . ,' and the difficulties re-listing the property and the cyclical nature of the real estate market. 'These uncertain impacts are precisely the impacts that satisfy the first element.'" (citation omitted)).

[62] Weisfield, *supra* note 16, at 988.

[63] This point can be further refined. More specifically, this approach would look at whether "at the time the contract is made it is foreseeable that the amount of actual damages would be difficult to determine even after a breach occurs." Eisenberg, *supra* note 34, at 230.

[64] Coopersmith, *supra* note 16, at 272 n.25 (citing John R. Hetland, *The California Land Contract*, 48 CAL. L. REV. 729, 736–37 (1960)); *see also* Weisfield, *supra* note 16, at 988 ("Conversely, measuring uncertainty at trial dramatically reduces the efficacy of liquidated damages clauses by forcing courts to treat many reasonable clauses as penalties. Requiring uncertainty at trial invalidates any clause where the amount of damages is then certain or can be easily calculated, regardless of the reasonableness of the fixed amount. Where the law furnishes a standard for computing damages, the amount will seldom be incapable of ascertainment or very difficult to prove at trial.").

[65] *See* Hutchison v. Tompkins, 259 So. 2d 129, 132 (Fla. 1972) ("Damages, especially in real estate transactions, are nearly always ascertainable at the time a contract is breached, because . . . the measure of damages involves determining the difference between the agreed purchase price and the market value of the land as of the date of breach.").

[66] Margaret H. Wayne Tr. v. Lipsky, 846 P.2d 904, 910 (Idaho 1993).

[67] *But see, e.g.*, *Hutchison*, 259 So. 2d at 132–33.

The second prong of the liquidated damages test requires that courts assess whether the parties intended to liquidate damages, or whether they intended to impose a penalty. This prong suffers from several internal flaws. First, the question to be answered is whether the clause is a penalty or not. A clause can still constitute an unreasonable penalty even if the parties did not intend for it to be a penalty.[68] Similarly, a clause can constitute a reasonable liquidated damages clause even if the parties intended it to be a penalty—so long as the clause does not have the effect of compelling performance.[69] Thus, the parties' intentions are not determinative of whether a clause is a valid liquidated damages clause or an unreasonable penalty. Second, the party intention test tends to be circular, at least in practice. If the other parts of the test are met, then courts will find that the parties "intended" to liquidate damages; if the other parts of the test are not met, then courts will find that the parties "intended" to impose a penalty.[70] Although many courts recite this prong of the liquidated damages test, most tend to overlook it in the ultimate analysis.[71]

The third prong of the test, reasonableness of the clause, is the most problematic. For starters, the reasonableness prong largely swallows the intentionality prong of the test. If a clause is determined to be unreasonable, then arguably the parties intended for the clause to operate as a penalty and not as a reasonable forecast of harm.[72] Additionally, there is an odd fit between the reasonableness prong and the uncertainty prong: "if damages truly are or will be

[68] *See* Olazábal, *supra* note 19, at 555 ("[T]he parties' subjective intent has little bearing on whether the clause is objectively reasonable.").

[69] *Id.* ("In that regard, Professor Farnsworth has argued: 'Although courts occasionally still allude to the intention of the parties, these references are fast disappearing. There is no good reason why a stipulation should not stand as one for liquidated damages, even though its purpose may have been that of coercion. Since the proscription is based on a policy against compulsion, the question is not whether the parties intended the stipulated sum as a penalty, but *whether the stipulation has the effect of compelling performance*.'").

[70] *Id.* at 555 n.242 ("Both courts and commentators have noted that the old intention test was circular: If the court felt the other parts of the test had been met, the parties 'intended' properly to liquidate their damages, and if the court was disinclined to enforce the clause, the parties did not have the requisite intention."). Some courts are even more rudimentary in their analysis. *See, e.g.*, Li v. Yaggi, No. CV145034810S, 2017 WL 3879260, at *9 (Conn. Super. Ct. July 25, 2017) ("As to the [party intention] element, the evidence establishes that the parties agreed to the terms and conditions of the purchase and sale agreement, including the liquidated damages clause which the plaintiffs do not dispute.").

[71] Olazábal, *supra* note 19, at 555 ("In recent years, although some courts still include 'the intent of the parties' as part of the recitation of the formal rule for liquidated damages, commentators have noted that the intent of the parties has been all but discarded as a legitimate factor in the decision of stipulated damage cases.").

[72] Coopersmith argues that the reasonableness prong swallows the uncertainty prong of the test as well, stating that "it implies that a more accurate estimation of the damages could have been made." Coopersmith, *supra* note 16, at 272. That a more accurate estimation of damages could have been made, though, does not have a bearing on the *fact* that the damages are uncertain/difficult to estimate (the first prong of the test). *Id.*

difficult to ascertain prior to the breach, how can the parties reasonably estimate them in the contract?"[73]

Leaving these two thorny issues aside, the main issue with the reasonableness prong, much like the uncertainty prong, is determining at what point to measure reasonableness. That is, must the clause be a reasonable forecast of harm as of the date of contracting? Or, must the clause be a reasonable forecast of harm when considering the actual harm to the aggrieved party?[74] Courts disagree on whether to assess the reasonableness of a liquidated damages clause prospectively (i.e., at the time of contract formation), or retrospectively (i.e., after the breach).[75]

The courts that hold that the reasonableness of a liquidated damages clause must be assessed at the time of contracting reason that "[t]his approach most accurately matches the expectations of the parties, who negotiated a liquidated damage amount that was fair to each side based on their unique concerns and circumstances surrounding the agreement, and their individual estimate of damages in event of a breach."[76] Under this logic, the whole point of a liquidated damages clause is to determine, ahead of time, what amount would be reasonable in the event of a breach. To look at the harm that is actually occasioned by a breach to potentially invalidate a liquidated damages clause would turn the rule on its head.

Conversely, some courts support an approach that would also look to the reasonableness of a liquidated damages clause as of the date of breach (or as of the date of trial). This is sometimes referred to as the "second look" approach,[77] whereby courts will take a second look at a clause that seemed reasonable at the time of contract formation, but now seems less so in light of actual events.[78] A variation of this approach is the "no actual harm" or "no actual injury" rule,

[73] Olazábal, *supra* note 19, at 523.

[74] Professor Eisenberg submits that there are actually four possibilities:

> [The reasonableness requirement] may mean any of the following: (A) that the liquidated damages must be a reasonable estimate of probable loss, looking forward from the time the contract is made; (B) that the liquidated damages must not be disproportionate to the loss that is actually sustained; (C) that the liquidated damages must satisfy either test A or test B; or (D) that the liquidated damages must satisfy both test A and test B.

Eisenberg, *supra* note 34, at 232.

[75] The *Restatement (Second) of Contracts* provides: "(1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated *or* actual loss caused by the breach . . . ." RESTATEMENT (SECOND) OF CONTRACTS § 356 (AM. LAW INST. 1981) (emphasis added).

[76] Kelly v. Marx, 705 N.E.2d 1114, 1117 (Mass. 1999).

[77] By contrast, the prospective approach, which assesses reasonableness at the time of contract formation, is sometimes referred to as "look forward" or "single look." Olazábal, *supra* note 19, at 519–20.

[78] Professor Eisenberg notes that this second-look approach "seems to be emerging law." Eisenberg, *supra* note 34, at 232.

whereby a court will invalidate a liquidated damages clause if the buyer can show that the seller suffered no actual harm from the breach.[79] These approaches are grounded in the notion that actual harm suffered by an aggrieved party has some role in assessing the reasonableness of the forecast made by the parties at the time of contracting.[80] The benefit to this second look or no actual harm approach is that it guards against unfair windfalls. Since the purpose of contract law is to compensate an aggrieved party, not to punish a breaching party,[81] an approach that takes into account actual harm (or, more accurately, lack thereof) is more consistent with the compensatory principle underlying contract law.

The vantage point from which a court assesses reasonableness—prospectively or retrospectively—is critical since many more liquidated damages clauses will pass muster under the former approach than under the latter approach. Almost anything can look "reasonable" without knowledge of what will actually happen. And almost anything can look "unreasonable" in light of actual knowledge. Aside from the timing of the reasonableness inquiry, another problem is how to actually assess reasonableness. Professor Olazábal observes that there are a variety of ways that courts undertake the reasonableness inquiry: as a percentage sum of some relevant number; in a holistic, "gestalt" manner; or as a presumption of reasonableness unless the amount is unconscionable.[82] Given the variety of approaches to determining whether a given clause is reasonable and the questions surrounding the vantage point from which to assess reasonableness, it is no wonder that this prong of the test "causes the most confusion and engenders the most litigation."[83]

[79] *See* Lind Bldg. Corp. v. Pac. Bellevue Dev., 776 P.2d 977, 982 (Wash. Ct. App. 1989); *see also* Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 220 A.2d 263, 268 (Conn. 1966) ("Implicit in the transaction is the premise that the sum agreed upon will be within the fair range of those just damages which would be called for and provable had the parties resorted to proof. Consequently, if the damage envisioned by the parties never occurs, the whole premise for their agreed estimate vanishes, and, even if the contract was to be construed as one for liquidated damages rather than one for a penalty, neither justice nor the intent of the parties is served by enforcement. To enforce it would amount in reality to the infliction of a penalty."); RESTATEMENT (SECOND) OF CONTRACTS § 356 cmt. b (AM. LAW INST. 1981) ("If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.").

[80] *See* Olazábal, *supra* note 19, at 520–21.

[81] "The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy." RESTATEMENT (SECOND) OF CONTRACTS § 356 cmt. a (AM. LAW INST. 1981).

[82] Olazábal, *supra* note 19, at 519.

[83] *Id.* at 518; *see also id.* at 522–23 ("In light of the various available methods for determining reasonableness, the different vantage points for review thereof, and the fact-intensive nature of any reasonableness inquiry, what a court will deem a 'reasonable' stipulated sum in any given case is anything but predictable—regardless of whether it involves strictly a review of what was reasonable as a pre-estimation of the potential damages ex ante, or an ex post analysis of disproportionality of the estimate to the actual damages

C. *Election Clauses*

There is an additional issue that has presented problems for courts with respect to liquidated damages in real estate contracts: election clauses. Sometimes a contract for the purchase and sale of real estate will allow the seller to elect between retaining the buyer's deposit as liquidated damages and suing for actual damages. For instance, a standard form approved by the Eastern Connecticut Association of Realtors provides that "[o]n default by either party, without the other party being in default, the party who is not in default shall have the right of: . . . retaining the deposit money as liquidated damages *or proceeding with any other remedy at law* or in equity."[84] Not surprisingly, courts are divided on whether to give effect to these election clauses.

Some courts have refused to give effect to clauses which allow a seller to elect actual damages over liquidated damages on the theory that allowing an election fundamentally undermines a liquidated damages clause. That is, the whole point of a liquidated damages clause is to set a sum—for better or for worse—that represents the amount that a defaulting buyer will owe in the event of a breach. If a seller is permitted to elect actual damages instead, the purpose of a liquidated damages clause is defeated. More specifically, one cannot say that the parties *intended* to liquidate damages if the seller reserved the right to sue for actual damages instead.[85] Allowing such an election gives the seller a

suffered. A court favoring party autonomy, like one that feels more comfortable basing a decision on principles of just compensation, will be able to find shelter in one or other of the available methods or time perspectives, if not in the ad hoc nature of the reasonableness inquiry itself. As such, almost any result is possible in a stipulated damages case.").

[84] E. CONN. ASS'N OF REALTORS, *supra* note 49, at 2 (emphasis added). In a leading Florida case on the election issue, the clause read as follows:

> DEFAULT: If buyer fails to perform this contract within the time specified, the deposit paid by buyer may be retained by or for the account of seller as consideration for the execution of this agreement and in full settlement of any claims for damages, and all obligations under this contract or seller at his option may proceed at law or in equity to enforce his legal rights under this contract.

Cortes v. Adair, 494 So. 2d 523, 524 (Fla. Dist. Ct. App. 1986). It is probably not a coincidence that many of these clauses do not specifically refer to the seller's right to pursue "actual damages" in lieu of simply retaining the deposit. By couching the right as one to "proceed at law or in equity," clauses like the one cited hide from the buyer the true nature of what they are agreeing to. *See id.* at 524–25.

[85] Lefemine v. Baron, 573 So. 2d 326, 329–30 (Fla. 1991) ("The reason why the forfeiture clause must fail in this case is that the option granted to [seller] either to choose liquidated damages or to sue for actual damages indicates an intent to penalize the defaulting buyer and negates the intent to liquidate damages in the event of a breach. The buyer under a liquidated damages provision with such an option is always at risk for damages greater than the liquidated sum. On the other hand, if the actual damages are less than the liquidated sum, the buyer is nevertheless obligated by the liquidated damages clause because the seller will take the deposit under that clause. Because neither party intends the stipulated sum to be the agreed-upon measure of damages, the provision cannot be a valid liquidated damages

guaranteed minimum recovery with no downside risk. If damages are zero, the seller can retain what is usually a sizeable deposit. If the seller's damages exceed the liquidated sum, the seller can sue for actual damages. In short, the seller is permitted to have his cake and eat it too. Meanwhile, the buyer is left forfeiting at least the amount of the deposit and potentially owing actual damages on top of that.[86]

Some courts, however, have permitted a seller to choose between suing for actual damages and enforcing a liquidated damages clause. Many of these cases simply rely on the "plain meaning" of the agreement, without questioning whether inserting a liquidated damages clause into a contract necessarily precludes an election of actual damages.[87] For instance, in *Phillips v. Gomez*, the Supreme Court of Idaho indicated that it was one of several states that allow sellers to choose between liquidated damages and actual damages.[88] The court stated, "Here, the rights of the parties were defined by the agreement . . . . In the event [the buyer] defaulted, [the agreement] gave [the seller] the option of either accepting the earnest money as liquidated damages *or* pursuing any other lawful right or remedy to which [the seller] was entitled."[89] The court in *Phillips* did

clause."); *see also* Grossinger Motorcorp v. Am. Nat'l Bank & Tr. Co., 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992) ("On its face, the optional nature of the liquidated damages clause shows that the parties never intended to establish a specific sum to constitute damages in the event of a breach."); Rogers v. Lockard, 767 N.E.2d 982, 992 (Ind. Ct. App. 2002) ("Here, the Agreement does not give the [sellers] a choice of liquidated damages or other legal remedies, but instead says buyer 'forfeits' the earnest money *and* the seller may pursue other legal and equitable remedies. If this were allowed, and that is what actually happened here, then the forfeiture of the earnest money acts as a punishment for breach of the contract, and not as an estimation of the actual damages. Thus, the 'liquidated damages' were in fact a penalty and should not be recoverable."); JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 645 (3d ed. 1987) (clauses that allow a party to elect actual damages in event of breach despite the existence of a liquidated damages clause in the contract "have been struck down as they do not involve a reasonable attempt definitively to estimate the loss").

[86] *See Cortes*, 494 So. 2d at 524 ("Resolution of this appeal turns on the validity of the default clause, *i.e.*, whether the [sellers] are entitled to retain as liquidated damages the $10,000 deposit paid by the [buyers]. This default clause confers the unilateral benefit on the [sellers] of choosing the avenue of relief following a breach. They may proceed at law for actual damages or in equity for specific performance; or, most attractively, they may simply elect to keep the $10,000 deposit if that amount exceeds actual damages. Such an option is not enforceable as a matter of law.").

[87] *See* Phillips v. Gomez, 405 P.3d 588, 595 (Idaho 2017) ("In this case, it is undisputed per [the contract], that [the seller] *had* the option of either accepting the earnest money as liquidated damages or pursuing any other lawful right or remedy (actual damages). The plain language of [the contract] supports these two different legal choices.").

[88] *Id.* at 593.

[89] *Id.*; *see also* Margaret H. Wayne Tr. v. Lipsky, 846 P.2d 904, 908–09 (Idaho 1993) ("We agree with the trial court's interpretation that this clause preserved the seller's right to seek actual damages. In spite of the fact that the clause is poorly written, it is clear from a reading of the agreement as a whole that the seller has the option of accepting the forfeited

not see any issue with enforcing the election clause in the agreement.[90] Similarly, in *Ravenstar v. One Ski Hill Place*, the court focused on freedom of contract to validate an election clause, stating:

> [T]he parties here were free to bargain for liquidated damages as a sole and exclusive remedy, but they did not, and instead bargained for the risk allocation memorialized in [the agreement]. Striking the option to liquidate damages . . . would be antithetical to the principles of freedom of contract and would require us to restructure the contract, which we are reluctant to do.[91]

Most of the courts that validate election clauses appear not to recognize the apparent inconsistency between the two remedies.[92]

* * *

It is clear that there are some fundamental issues that courts have not been able to resolve when it comes to enforcing liquidated damages clauses in contracts to purchase real estate. From what vantage point does a court assess reasonableness: prospectively or retrospectively? What exactly must be uncertain when it comes to damages? How does one assess whether the parties "intended" to liquidate damages? Does the inclusion of an election clause necessarily mean that the parties did not intend to liquidate damages? The answers vary considerably among jurisdictions, leading to confusion and contradiction in the case law.

IV. REAL ESTATE DEPOSITS: THE CASE LAW

As discussed above, the doctrinal test for liquidated damages suffers from some serious inconsistencies and ambiguities. This has produced case law that

earnest money as liquidated damages, bringing an action for recovery of actual damages, or seeking specific performance.").

[90] *Phillips*, 405 P.3d at 594.

[91] Ravenstar, LLC v. One Ski Hill Place, LLC, 401 P.3d 552, 556 (Colo. 2017) (citations omitted).

[92] Those that do try to "reason away" the inconsistency use questionable logic. *See id.* ("The freedom to contract for the alternative damages remedies of liquidated damages and actual damages does not negate the parties' intent to liquidate damages. All that this court requires is that 'the parties intended to liquidate damages.' An intent to liquidate damages should not be conflated with an intent to liquidate damages as the sole and exclusive remedy. The parties must only mutually intend to make liquidated damages one of the available remedies that the non-breaching party could pursue. So long as the parties mutually intend the stipulated sum to be the agreed-upon measure of damages if the non-breaching party elects liquidated damages, the mutual intent element . . . is satisfied. Therefore, the mere presence of an option to seek either liquidated damages or actual damages does not render the liquidated damages clause invalid as a matter of law.") (citations omitted).

is a bit of a "hot mess."[93] With that said, there are some general themes and trends to be gleaned from the case law related to deposits in real estate transactions. First, courts are extremely reluctant to invalidate liquidated damages clauses in real estate contracts. This means that buyers are safe to assume that they will likely forfeit their deposit in any given real estate transaction. Second, when courts are called upon to examine liquidated damages clauses, they usually fail to apply any meaningful analysis to them; instead, courts simply rubber-stamp clauses that fall within some given range considered customary in the local area. Third, courts routinely invoke the inherent "uncertainty" of the real estate market in order to validate liquidated damages clauses. And, finally, courts tend to overstate the harm (or potential harm) to the seller to justify upholding liquidated damages clauses. The net result of all of this is that the vast majority of liquidated damages clauses in contracts to purchase real estate pass judicial scrutiny.

A. *Courts Are Loath to Invalidate Liquidated Damages Clauses in the Real Estate Context*

Professor Hillman argues that courts police liquidated damages clauses "enthusiastically" and "exuberantly," often overturning them "with greater zeal and vigor than they strike other contract terms."[94] When it comes to liquidated damages clauses in contracts to purchase real estate, however, Professor Hillman's observation does not hold true. Courts in the real estate context will, by and large, enforce liquidated damages clauses that require a buyer to forfeit his deposit. Unless the clause is unconscionable, or there is some other separate

[93] For a brief history of the expression, see Katy Steinmetz, *How the Meaning of 'Hot Mess' Has Changed through History*, TIME (Apr. 2, 2014), http://time.com/46267/hot-mess-history-amy-schumer/ [https://perma.cc/54BZ-QF55].

[94] Robert A. Hillman, *The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages*, 85 CORNELL L. REV. 717, 726, 732, 737 (2000). Many academics, including Professor Hillman, believe that courts should routinely enforce liquidated damages clauses without scrutiny. *See, e.g.*, Larry A. DiMatteo, *Penalties as Rational Response to Bargaining Irrationality*, 2006 MICH. ST. L. REV. 883, 889 ("Parties should be allowed to negotiate enforceable penalty clauses."). *But see* Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CALIF. L. REV. 1743, 1779–89 (2000) (arguing that cognitive limitations may preclude accurate assessment of the significance of breach); Seana Valentine Shiffrin, *Remedial Clauses: The Overprivatization of Private Law*, 67 HASTINGS L.J. 407, 411 (2016) ("The burgeoning permissive stance toward remedial clauses fails adequately to appreciate the public's interest in reserving remedial decisionmaking to impartial adjudicators who are positioned to tailor remedies with sensitivity to the details of the circumstances and significance of a breach.").

basis for non-enforcement,[95] it is a fairly safe bet that a seller will be able to retain a buyer's deposit in a real estate transaction.[96]

Case law illustrates just how deferential courts are to the parties' agreement with respect to liquidated damages clauses. Buyers have forfeited extremely large sums of money even where it is apparent that the seller suffered no actual loss—and in fact, profited handsomely from the breach.[97] *Karimi v. 401 North Wabash Venture* provides a prime example of courts' hands-off approach to liquidated damages clauses in the real estate context.[98] In *Karimi*, the buyers entered into an agreement to purchase a condominium unit and three parking spaces from the seller for $2,188,464.[99] The buyers paid $328,269.60 (15% of the purchase price) as earnest money.[100] The buyers were not able to complete the purchase.[101] Six months later, the seller sold the unit and two parking spaces for $2.5 million.[102] The sellers ended up making $400,000 more[103] on the sale to the new purchaser than they would have if the buyers had not breached.[104] The sellers then sought to retain the deposit as liquidated damages.[105]

The court in *Karimi* had absolutely no problem upholding the liquidated damages clause and requiring the buyers to forfeit almost $330,000.[106] It provided blanket validation to a clause that required a forfeiture of 15% of the purchase price: "Liquidated damages in the amount of 15% of the purchase price is a reasonable amount considering the potential loss each party faced at the time of contracting."[107] Adding insult to injury, the court used the seller's $400,000 windfall to "prove" that damages were uncertain at the time of contracting, stating, "plaintiffs' argument concerning defendant's sale of the unit for $400,000 more than the contract price proves the validity of the liquidated damages provision because it shows how uncertain and difficult it was for the

[95] For instance, a court may find that the presence of an election clause invalidates the liquidated damages clause.

[96] *See, e.g.*, Leeber v. Deltona Corp., 546 A.2d 452, 456 (Me. 1988) ("It is undisputed that this liquidated damage amount of $22,530, 15% of the total contract price of the Florida real estate, was reasonable on its face and not a penalty.").

[97] Some courts have proven sympathetic to arguments that a liquidated damages clause should be invalidated where the seller suffered no actual loss. *See, e.g.*, Nohe v. Roblyn Dev. Corp., 686 A.2d 382, 383 (N.J. Super. Ct. App. Div. 1997) (court ordered seller to return an almost $80,000 deposit where seller sold property for $193,995.30 *more* than original contract price).

[98] Karimi v. 401 N. Wabash Venture, 952 N.E.2d 1278, 1288 (Ill. App. Ct. 2011).

[99] *Id.* at 1282.

[100] *Id.*

[101] *Id.*

[102] *Id.*

[103] This takes into account the value of the extra parking spot that the sellers retained.

[104] *See Karimi*, 952 N.E.2d at 1282.

[105] *Id.*

[106] *Id.* at 1290.

[107] *Id.* at 1288.

parties to ascertain actual damages at the time of contracting."[108] At the end of the day, the sellers in *Karimi* profited to the tune of almost three-quarters of a million dollars[109] because of the buyer's breach, and yet, the court showed no hesitation in enforcing the liquidated damages clause.[110]

Savchuk v. Jerde is another case that illustrates the willingness of courts to entertain provisions that are clearly penalties.[111] In *Savchuk*, the buyer provided $20,000 as a deposit on a $725,000 property.[112] The buyer subsequently made a series of payments totaling $480,000, which were characterized as "non-refundable."[113] The court considered whether the contractual provisions requiring the buyer to forfeit a total of $500,000 on a $725,000 property were unenforceable penalties.[114] In remanding the issue back to the trial judge, the *Savchuk* court noted:

> [I]f the nonrefundable payment provision was an attempt to estimate damages in the event of default, there are also material issues of fact as to the reasonableness of the prospective estimate of potential losses, including fluctuation in the real estate market, the unique position of the parties when drafting the extension agreement, the level of sophistication of the parties, and evidence of actual damages.[115]

It stands to reason that provisions which require a buyer to forfeit almost 70% of the purchase price of a property are unenforceable as a matter of law.[116] That the court felt the need to remand the issue to the trial court to conduct a full inquiry into the issue of whether the provisions were a penalty speaks to how willing courts are to entertain such clauses.

In *Phelan v. Adelphia Communications Corp.*, the court also took a very permissive view of liquidated damages.[117] In that case, the corporate seller originally sold to a buyer who put down a 10% deposit on a $3.4 million property; when that buyer was not able to complete the transaction, he forfeited

[108] *Id.*

[109] When one adds the seller's profit from the resale to the liquidated damages amount.

[110] *See* Burke v. 401 N. Wabash Venture, 714 F.3d 501, 504 (7th Cir. 2013) (court approved a forfeiture of 20% of the purchase price, a total of $456,426, in a failed real estate transaction involving the same condominium tower); Culbreath Revocable Tr. v. Sanders, 979 So. 2d 704, 709, 712 (Miss. Ct. App. 2007) (buyer forfeited $65,000 deposit even though seller made $350,000 profit on resale).

[111] *See generally* Savchuk v. Jerde, No. 64269–3–I, 2010 WL 4277872 (Wash. Ct. App. Nov. 1, 2010).

[112] *Id.* at *1.

[113] *Id.* at *2.

[114] *Id.* at *6.

[115] *Id.*

[116] This is especially so in light of Washington's statute, which prescribes a maximum deposit of 5%. *Id.* at *3 (citing WASH. REV. CODE § 64.04.005 (2005)).

[117] *See* Phelan v. Adelphia Commc'ns Corp., No. 4:CV-08-0730, 2009 WL 4559456, at *9 (M.D. Pa. Dec. 1, 2009). Note that the *Phelan* case involved a commercial property.

$340,000.[118] When the property was re-listed, the seller required a much more sizeable deposit of $1 million.[119] At a deposition, the treasurer of the seller testified that the $1 million deposit was required "in order to make sure that it was serious buyers that were coming" and "[t]o make sure that we had parties that were able to close on whatever the ultimate purchase price was, that they had the financial wherewithal to close."[120] Ultimately, the second buyer was not able to complete the transaction.[121] The seller re-listed the property and ultimately sold it for $3.6 million, $200,000 *more* than the second buyer was going to pay.[122] The seller then sought to retain the $1 million deposit as liquidated damages.[123]

The court was required to decide whether the $1 million deposit was an unenforceable penalty.[124] The issue should not have been a close call. The buyer paid almost 30% of the purchase price as a deposit.[125] Additionally, within five months, the seller made a profit of $200,000 more than it would have made if the buyer had performed the contract.[126] In short, the seller made a profit of $1.2 million as a result of the buyer's breach (not including the $340,000 it retained because of the original default).[127] The court, however, was of the view that there remained at least one genuine issue of material fact in dispute.[128] The seller "pointed to evidence . . . that it took into account such factors as the property's location, future remarketing costs, legal fees, the annual carrying costs of nearly $700,000 on the property, and the 'uncertain real estate market' when [it] was attempting to sell the property when it decided to increase the required deposit."[129] The court indicated that the facts in dispute were material and had "significant implications concerning the reasonableness and proportionality of the $1,000,000 deposit."[130]

It would seem that under no stretch of the imagination is a 30% deposit reasonable. Just prior to the sale in question, the seller only required a 10% deposit.[131] Nothing changed in the interim that would bear on the seller's damages. Moreover, the property was actually appraised at $6.3 million, meaning that the seller was almost certain not to incur any expectancy losses.[132]

[118] *Id.* at *3.
[119] *Id.*
[120] *Id.* (alteration in original).
[121] *Id.* at *4. The buyer alleged that his lawyer misappropriated $2,000,000 from him. *Id.*
[122] *Id.*
[123] *Phelan*, 2009 WL 4559456, at *4.
[124] *Id.* at *7.
[125] *Id.* at *4.
[126] *Id.*
[127] *Id.* at *3.
[128] *Id.* at *2.
[129] *Phelan*, 2009 WL 4559456, at *9.
[130] *Id.*
[131] *Id.* at *3.
[132] *Id.* at *2.

As for carrying costs, a court cannot consider "annual" carrying costs unless there is some indication that it would take a year to resell the property. Moreover, it is unclear how a property selling for $3.4 million could incur $700,000 in carrying costs when there is apparently no mortgage on the property. The seller indicated that carrying costs "included utilities, property taxes, insurance, and other services."[133] Notably, the seller did not list mortgage interest as a component of carrying costs.[134] Finally, there were multiple offers on the property at the time the buyer purchased it, indicating that reselling should not have been problematic (and, indeed, it was not).[135] That the court would deny summary judgment for the buyer shows just how far courts are willing to go to entertain arguments that almost any deposit is reasonable.

As a general proposition, buyers have an uphill battle trying to get their deposits back in a failed real estate transaction. Cases invalidating a liquidated damages clause as being an unenforceable penalty are few and far between.[136] By contrast, there are many cases of a buyer forfeiting a deposit despite the seller not being harmed at all by the breach—and in many cases, being much better off because of the breach.[137]

B. *Courts Rubber-Stamp Liquidated Damages Clauses in the Real Estate Context*

Courts seem to treat it as settled law that a buyer automatically forfeits his deposit when he breaches an agreement to purchase real estate, regardless of the amount of the deposit or the circumstances of the particular case. A number of cases, if not the majority, fail to apply any meaningful analysis to the issue of

[133] *Id.* at *4 n.3. It is hard to believe that these carrying costs would add up to $700,000 per year, over 20% of the total value of the property. That is to say, in five years, the carrying costs would exceed the purchase price of the property.

[134] *Id.*

[135] *Phelan*, 2009 WL 4559456, at *4.

[136] *See* Nohe v. Roblyn Dev. Corp., 686 A.2d 382, 383 (N.J. Super. Ct. App. Div. 1997) (court ordered seller to return an almost $80,000 deposit where seller sold property for $193,995.30 *more* than original contract price); Grossinger Motorcorp, v. Am. Nat'l Bank & Tr. Co., 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992) (finding the liquidated damage provision unenforceable and that defendant was only entitled to actual damages); Terraces of Boca Assocs. v. Gladstein, 543 So. 2d 1303, 1303–04 (Fla. Dist. Ct. App. 1989) (holding that the liquidated damage provision of the contract was unenforceable because it "lacked mutuality of obligation").

[137] *See* Karimi v. 401 N. Wabash Venture, 952 N.E.2d 1278, 1288 (Ill. App. Ct. 2011) (sellers made $400,000 more on the sale to a new purchaser than they would have if the buyers had not breached and retained the $330,000 forfeited by the buyers); *Phelan*, 2009 WL 4559456, at *3 (seller retained both a $340,000 deposit from the first buyer and a one million deposit from the second buyer and sold the property for $200,000 more than the second buyer was going to pay); NRT New Eng., Inc. v. Moncure, No. 20053861, 2008 WL 4739794, at *2 (Mass. Super. Ct. Oct. 23, 2008) (just over a month after the scheduled closing, the seller sold the property for $1.895 million, $45,000 more than the original selling price).

whether a liquidated damages clause in the form of a retained deposit constitutes an unenforceable penalty. For instance, in *Paez v. Coleman-Toll Ltd. Partnership*, the court stated that "the contract clearly allowed [the seller] to retain, as liquidated damages, the monies paid by [the buyer] if he failed to perform. Because [the buyer] has admitted that he did not perform, [the seller] was entitled to retain the monies paid by [the buyer]."[138] The reasoning is simply, "you forfeit the deposit because you agreed to forfeit the deposit."

Moreover, rather than endeavoring to ascertain whether the stipulated amount constitutes a penalty in any particular real estate transaction, many courts provide blanket validation to liquidated damages clauses that fall within some range that is considered the norm in that particular community. The case law is replete with references to liquidated damages clauses being enforceable simply because they are consistent with percentages that courts have recognized as reasonable in other cases.[139] For these courts, so long as the amount specified in the contract is equal to, or lower than, the amount that other courts have validated, the clause will automatically pass muster.[140]

Even where courts do purport to engage in some sort of analysis of the liquidated damages clause at issue, the "analysis" is short and perfunctory. *Ivanov v. Sobel*, for example, is illustrative of the cursory approach that many

[138] Paez v. Coleman-Toll Ltd., 281 P.3d 1207, 1207 (Nev. 2009); *see also* Hegner v. Reed, 770 N.Y.S.2d 87, 89–90 (2003) ("Finally, the sellers were entitled to retain the entire $130,000 down payment as liquidated damages in accordance with the terms of the contract. Contrary to the Supreme Court's conclusion, the sellers' retention of the entire down payment constitutes neither unjust enrichment nor an 'unenforceable penalty.'").

[139] For instance, in *NRT New England, Inc. v. Moncure*, the court stated:

> Here, it is not disputed that a 5% deposit was the norm in the real estate industry for a purchase and sale agreement, and that Coldwell Banker customarily stipulated that at least 5% be retained. Courts, moreover, have upheld 5% deposit clauses in other failed real estate transactions as a fair reflection of anticipated damages.

NRT New Eng., Inc., 2008 WL 2745082, at *2. In *Tsiropoulos v. Radigan*, the court indicated that "[a] liquidated damages clause allowing the seller to retain 10 percent of the contract price as earnest money is presumptively a reasonable allocation of the risks associated with default." Tsiropoulos v. Radigan, 133 A.3d 898, 904 (Conn. App. Ct. 2016) (citing Vines v. Orchard Hills, Inc., 435 A.2d 1022 (1980)); Culbreath Revocable Tr. v. Sanders, 979 So. 2d 704, 712 (Miss. Ct. App. 2007) ("The earnest money here was approximately 7.6% of the purchase price. As a matter of published record, an earnest money amount of 7.6% seems to be reasonable as evidenced in many cases reviewed by the appellate courts of this State noting similar percentages of earnest money.").

[140] *See, e.g.*, Bradley v. Sanchez, 943 So. 2d 218, 222 (Fla. Dist. Ct. App. 2006) ("Furthermore, forfeiture of 4.85% of the total sales price (or $510,000) as liquidated damages is not an unconscionable amount of damages."); *see also* Lefemine v. Baron, 573 So. 2d 326, 328 (Fla. 1991) (10% of the contract price found not unconscionable); Watson v. Ingram, 851 P.2d 761, 765 (Wash. Ct. App. 1993), *aff'd*, 881 P.2d 247 (Wash. 1994) ("Here, the $15,000 earnest money was less than 5 percent of the purchase price. Such a small percentage of the entire purchase price is not an unreasonable amount to require as liquidated damages and, consequently, the parties' agreement satisfies the first of *Lind*'s three requirements for an enforceable liquidated damages clause.").

courts take to the issue of liquidated damages in real estate contracts.[141] In that case, the buyers put down a $30,000 deposit on the purchase of a $300,000 home.[142] When an escrow agent ended up absconding with the funds that the buyers had set aside for the purchase, the buyers had no choice but to default on their obligation to complete the sale.[143] Rather than assess whether $30,000 was a reasonable liquidated damages clause or an unenforceable penalty, the court summarily ordered the buyers to forfeit their deposit.[144] The full extent of the court's analysis reads, "The $30,000 deposit was ten percent of the purchase price, and was not grossly disproportionate to any damages that the [sellers] might reasonably expect to incur as a result of a default on a $300,000 dollar sale, and the [sellers] could have intended only to induce full performance through the deposit amount."[145] The court's analysis was one sentence.[146] It concluded that $30,000 was not "grossly disproportionate" to any damages the sellers might have incurred, without looking at what those damages were or what those damages could have been.[147]

Song v. 4170 & 4231 & 4271 Altoona Drive Holdings Ltd. is equally superficial in its legal treatment of the deposit.[148] In *Song*, the buyers made a $361,200 deposit on a property that they had purchased at auction for $3,440,000.[149] In concluding that the buyers were required to forfeit their deposit of 10.5% of the purchase price, the court stated, "We conclude that the liquidated damages provision is reasonable and actual damages were uncertain. Accordingly, because the [buyers] breached the agreement by refusing to close on the Property, the district court correctly held that [the seller] is entitled to the deposit as liquidated damages."[150] Just like the analysis in *Ivanov*, the court rubber-stamped the 10.5% liquidated damages clause, saying simply that it was

[141] Ivanov v. Sobel, 654 So. 2d 991, 992–93 (Fla. Dist. Ct. App. 1995).

[142] *Id.* at 992.

[143] *Id.*

[144] *Id.*

[145] *Id.* at 992–93.

[146] It simply parroted back the test that Florida courts use to determine whether a liquidated damages clause is enforceable. *See* Mineo v. Lakeside Vill. of Davie, LLC, 983 So. 2d 20, 21–22 (Fla. Dist. Ct. App. 2008) ("[T]he sum stipulated to be forfeited must not be so grossly disproportionate to any damages that might reasonably be expected to follow from a breach as to show that the parties could have intended only to induce full performance, rather than to liquidate their damages." (citing Lefemine v. Baron, 573 So. 2d 326, 327 (Fla. 1991))).

[147] *Ivanov*, 654 So. 2d at 992.

[148] Song v. 4170 & 4231 & 4271 Altoona Drive Holdings Ltd., 616 F. App'x 645, 646–47 (5th Cir. 2015) (per curiam).

[149] *Id.* at 647.

[150] *Id.* at 650.

"reasonable and actual damages were uncertain."[151] There is no discussion of liquidated damages as they actually related to the facts of the case.[152]

These cases are typical of the courts' liberal approach to liquidated damages clauses in the real estate setting. Courts do not carefully examine the question of whether a given provision is a valid liquidated damages clause or an unenforceable penalty. Instead, they blindly endorse almost all liquidated damages clauses as being enforceable.

C. *Courts Invoke the "Uncertainty" of the Real Estate Market to Validate Any Liquidated Damages Clause*

Many of the cases fail to conduct a comprehensive analysis of the reasonableness of the liquidated damages clause by invoking the inherent "uncertainty" of the real estate market. By focusing on how unpredictable, uncertain, speculative, and volatile the real estate market is, courts often avoid a robust liquidated damages analysis while creating the illusion that they have actually engaged in one.[153]

Consider, for instance, *NRT New England, Inc. v. Moncure*.[154] In *NRT New England*, the buyer put down a 5% deposit on a $1.85 million property (a total of $91,500).[155] The buyer was apparently unable to secure financing and did not close on the deal.[156] The buyer brought an action seeking a declaration that it was entitled to its deposit back on the ground that the liquidated damages clause was unenforceable.[157] The court held that the seller could keep the deposit, focusing its analysis almost exclusively on how uncertain damages are in real estate contracts.[158] In this respect, the court stated:

> Actual damages in real estate transactions are particularly *hard to ascertain* at the time a contract is entered into because *it is hard to predict* when and for what price a property will resell if the deal falls through. . . . [T]he parties could not know what delays *might ensue*, *what might* occur in the real estate market,

[151] *Id.*

[152] *See* White v. Strange, 80 So. 3d 1189, 1193–94 (La. Ct. App. 2011) (validating liquidated damages of approximately 15% of the purchase price without any analysis of the facts).

[153] *See* Kotseas v. Anderson, No. 0001462, 2001 WL 881471, at *1 (Mass. Super. Ct. Apr. 4, 2001) ("I find that the deposit paid in the amount of $5000.00, represents almost exactly 5% of the purchase price agreed upon. Given the uncertainty of measuring actual damages anticipated from the date of the contract, given market conditions and the length of time that a property might have to be carried, this deposit is reasonable in amount and as expressed as a percentage of sales price; additionally, it conforms with standard practice.").

[154] NRT New Eng., Inc. v. Moncure, No. 20053861, 2008 WL 2745082, at *3 (Mass. Super. Ct. June 20, 2008).

[155] *Id.* at *1.

[156] *Id.*

[157] *Id.*

[158] *Id.* at *3.

> or how a failed sale *might affect* [the seller's] plans. Real estate purchase and sale agreements are precisely the type of contracts that are amendable [sic] to liquidated damages provisions.[159]

Nowhere in the judgment did the court look at whether the damages were a reasonable forecast of harm. The court simply assumed that the damages *must have been* a reasonable forecast of harm because the harm was inherently unpredictable. The case failed to mention that just over a month after the scheduled closing, the seller sold the property for $1.895 million, $45,000 more than the original selling price.[160] Accordingly, it seems that the seller suffered no actual loss in the case.[161]

By invoking the inherent "uncertainty" of the real estate market, courts are able to validate almost any liquidated damages clause. Given that anything *could happen* (regardless of whether it is likely *to happen*), courts can easily deem a liquidated damages clause to be a "reasonable" forecast of harm.[162] Almost anything is reasonable, after all, if the eventual outcome is uncertain.

D. *Courts Bolster Harm to Validate the Reasonableness of Liquidated Damages Clauses*

Courts tend to show very little sympathy toward buyers and routinely order that they forfeit a great deal of money because they breached a contract to purchase real estate. To be sure, sellers can be—and often are—harmed by a buyer's breach. But, courts tend to overstate the harm in order to buttress the conclusion that a buyer should have to forfeit his deposit. Rarely do judges engage in a comprehensive analysis of the actual harm that a seller suffered, or was likely to suffer,[163] as a result of a buyer's breach. If they did so, then they

[159] *Id.* (emphasis added) (citations omitted).

[160] *NRT New Eng., Inc.*, 2008 WL 4739794, at *2.

[161] *Id.*; *see also* Kelly v. Marx, 705 N.E.2d 1114, 1117 (Mass. 1999) ("The deposit, five per cent of the purchase price, was a reasonable forecast of the defendants' losses that would result if the buyers were to breach the agreement. These costs could arise from a host of issues relating to finding another buyer and waiting for an uncertain period of time before selling their property, and in light of the risk of an undeterminable loss that is dependant [sic] on many factors (primarily the shape of the real estate market at the time of the breach). The sum is not grossly disproportionate to the expected damages arising from a breach of the sale agreement, nor is it 'unconscionably excessive' so as to be defeated as a matter of public policy.").

[162] *See* S.F. Distribution Ctr. v. Stonemason Partners, 183 So. 3d 391, 395 (Fla. Dist. Ct. App. 2014) ("Such a determination would invite speculation in assessing what a certain piece of real property might be worth weeks, months or even years after a contract is signed."); *see also* Hutchison v. Tompkins, 259 So. 2d 129, 132 (Fla. 1972) (observing that the "land sale market in Florida fluctuates from year to year and season to season, and it is generally impossible to say at the time a contract for sale is drawn what vendor's loss (if any) will be should the contract be breached by purchaser's failure to close").

[163] Some jurisdictions do not take into account actual harm, as they assess the validity of a liquidated damages clause prospectively.

could meaningfully assess whether a deposit constitutes a reasonable forecast of harm.

Below, I examine the damages that a seller may suffer as a result of a buyer's breach, and discuss how courts tend not to appreciate the nuances of the damages calculation, which results in an overinflation of harm. This overinflation of harm, in turn, serves to make the liquidated damages clause look comparatively reasonable.

1. *Expectancy Damages*

Most importantly, the seller may lose the "benefit of his bargain," that is, the difference between the contract price and the market price of the property on the date of the breach.[164] It is black letter law that damages for an aggrieved seller are measured by the market price of the property on the date of the breach. However, very little effort is made by courts to ascertain that number.[165] Instead, courts routinely assume that the ultimate resale price is, in fact, the market price as of the date of the breach. For instance, if a buyer breaches a contract to purchase a home for $400,000, and the seller resells the home five months later for $380,000, the automatic assumption is that the seller has "lost" $20,000. However, if the market dipped after the buyer's breach, the loss is on the seller—not the buyer.[166] A breaching buyer must pay damages for the market price

[164] Matthew Ingber, Comment, *Protecting the Benefit of a Seller's Bargain in Real Estate Contracts*, 30 TOURO L. REV. 761, 761 (2014) ("Courts measure damages for breach of a real estate contract based on the difference between the contract price and the fair market value of the property at the time of the breach, which seeks to protect the injured party's expectation interest."); E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.12 n.31 (3d ed. 2004) (damages in real estate transactions are measured at the time of the breach); RICHARD A. LORD, WILLISTON ON CONTRACTS § 66:80 (4th ed. 2002) ("[T]he generally accepted measure of damages is the difference between the contract price and the fair market value of the property at the time of the breach.")

[165] In Hawkins v. Foster, 897 S.W.2d 80, 87 (Mo. Ct. App. 1995), the court awarded the sellers the difference between the contract price and the resale price (resale occurred approximately one year later). The court discounted the sellers' own admission that "the fair market value of the residence on the day of closing and on the day of the resale was $149,500." *Id.*; *see also* 1472 N. Milwaukee, Ltd. v. Feinerman, 996 N.E.2d 652, 659 (Ill. App. Ct. 2013) ("There is no dispute plaintiffs sold the property eight months after defendant's breach for a price agreed to six months after the breach. . . . The trial court was well within its discretion in weighing this evidence and concluding the sale price . . . agreed to six months after the breach . . . established the fair market value of the property on the day of defendant's breach, November 17, 2006.").

[166] DENNIS L. GREENWALD & STEVEN A. BANK, CALIFORNIA PRACTICE GUIDE REAL PROPERTY TRANSACTIONS Ch. 11-C, 11:104 (Carol M. Clements ed., 2018) ("Moreover, because general damages . . . are measured by the value of the property as of the date of the buyer's breach, a seller's general damages remedy may be unsatisfactory even in a declining real estate market: i.e., if the seller is unable to consummate a quick resale, the property's value will continue to decline after the intended closing date, yet the seller will be

differential as of the date of his breach. Any softening of the market, and subsequent loss, is absorbed by the seller.[167] Even though this is a well-established principle of law, very few courts actually engage in an analysis of what the market price was on the date the buyer breached.[168] In fact, it appears that the automatic assumption of litigants is that the resale price is the appropriate comparator.[169] For instance, in *Rogers v. Lockard*, the breaching buyers conceded that the difference between the contract price and resale price constituted the seller's expectancy damages even though the resale took place over six months after the breach.[170]

If courts applied the damages formula correctly, most sellers' expectancy losses should be negligible.[171] This is based on two assumptions: first, that the

limited . . . to damages measured by the value of the property as of the intended closing date." (citations omitted)).

[167] For an argument that damages should be measured by reference to the resale value, see Ingber, *supra* note 164, at 763 ("[A]pplying the time of breach rule . . . to real estate contracts inadequately protects an injured seller's expectation damages. Instead, real estate vendors would be afforded greater protection for their expectation interest if damages were measured as the difference between the contract price and subsequent lower resale price so long as the seller sufficiently mitigates damages."); *see also* UNIFORM LAND TRANSACTIONS ACT § 2-504(a) (UNIF. ST. LAW COMM'N 1975) ("If a buyer wrongfully rejects, otherwise commits a material breach, or repudiates as to a substantial part of the contract, the seller may resell the real estate in the manner provided in this section and recover any amount by which the unpaid contract price and any incidental and consequential damages exceeds the resale price, less expenses avoided because of the buyer's breach.").

[168] Some courts, in fact, refuse to consider facts that would provide some evidence of valuation on the date of the breach. *See 1472 N. Milwaukee, Ltd.*, 996 N.E.2d at 659 ("[Buyer] contends that the evidence the trier of fact should have considered in determining fair market value on the date of the breach was the price for which the property was relisted and the executed contracts during the carry period. Defendant cites no case law to support the proposition that the price at which the property was relisted or the subsequent contracts that failed are competent evidence of fair market value. Fair market value of real property is based on actual sales, where a closing has occurred, not on pending sales."). Other courts simply ignore the well-established rule that damages are assessed as of the date of breach. *See* Kuhn v. Spatial Design, Inc., 585 A.2d 967, 971 (N.J. Super. Ct. App. Div. 1991) ("A rule that restricts damages for breach of a contract to buy real estate to the difference between contract price and value at the time of breach (plus expenses) works fairly only in a static market. A damage rule works fairly in a declining market only if it takes account of slowing sales and falling values. In such cases, where the seller puts the property back on the market and resells, the measure is not contract price less value at the time of breach, but rather the resale price, if it is reasonable as to time, method, manner, place and terms.").

[169] *See* Parker v. Knauf, No. CV085007670, 2010 WL 1375564, at *8 (Conn. Super. Ct. Mar. 3, 2010).

[170] Rogers v. Lockard, 767 N.E.2d 982, 993–94 (Ind. Ct. App. 2002).

[171] *See* Bradley v. Sanchez, 943 So. 2d 218, 222 (Fla. Dist. Ct. App. 2006) (buyers breached by not applying for financing within five days of signing the purchase and sale agreement; expectancy damages were likely nonexistent). *But see* Bill v. Cusano, No. CV065005899S, 2009 WL 1959473, at *3 (Conn. Super. Ct. June 8, 2009) ("As such, the amount of damages suffered by the defendants may include the three days of lost sales

contract price reflects the market value, and second, that the majority of real estate contracts are breached by a buyer shortly after entering into the agreement.[172] As one commentator observes, "Due to these factors, the purchase price and the fair market value at the time of the breach . . . it is unlikely that a non-breaching seller will have a claim for damages during a static market, unless the seller secures a buyer willing to pay more than fair market value."[173] Despite this truism, courts routinely (and erroneously) assume that the resale price is the fair market value on the date of the breach.[174] This, in turn, results in an overinflation of the harm to the seller, justifying the retention of the deposit.

2. *Consequential Damages: Carrying Costs and Additional Expenses*

A seller is also entitled to consequential damages: those damages that are reasonably foreseeable as a probable result of the breach.[175] This would include things like carrying costs (e.g., mortgage interest, property taxes, insurance, maintenance), as well as fees and expenses associated with reselling a property (e.g., attorney costs, marketing expenses, etc.).[176] Importantly, the damages

opportunity and the difference in market value between the time the contract was executed and the time it was breached.").

[172] Ingber, *supra* note 164, at 769. Note that the majority of real estate transactions close, on average, within sixty days of the original offer. *See* Braunstein, *supra* note 39, at 270 ("When the attorneys were asked how long a typical transaction takes from offer to closing . . . [t]he average time reported was sixty days, with about half of the attorneys stating between forty-five to sixty days and the other half sixty to ninety days.").

[173] Ingber, *supra* note 164, at 769.

[174] *See, e.g.*, Peterson v. McAndrew, 125 A.3d 241, 248 (Conn. App. Ct. 2015) (buyers breached on July 8, 2011 and property was sold the very next month; court used the resale price as the reference point for calculating damages even though it is unlikely that the market changed significantly in that one-month period).

[175] RESTATEMENT (SECOND) OF CONTRACTS § 351 (AM. LAW INST. 1981) ("(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made. (2) Loss may be foreseeable as a probable result of a breach because it follows from the breach (a) in the ordinary course of events, or (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know."). Consequential damages must be offset against any potential expectancy gains in order to arrive at an accurate damages calculation. For instance, if the seller made a $20,000 expectancy gain and suffered $5000 in consequential losses, the seller does not have any compensable injury. *See* Smith v. Mady, 194 Cal. Rptr. 42, 44 (Ct. App. 1983) ("The sole issue is whether a defaulting purchaser of real property is entitled to credit, against damages from his default, the increase in proceeds of a subsequent, but rapid, resale at a higher price. We resolve the issue in the affirmative and reverse."). In a rising market "[c]onsequential damages to the seller are often minimal, and . . . the expenditures . . . are such that they would have been incurred in the second transaction as well." David B. Dimitruk & Jane L. O'Hara Gamp, *Damages for Breach of Seller-Buyer Contracts*, *in* 1 CALIFORNIA REAL PROPERTY REMEDIES AND DAMAGES § 4.75 (Bonnie C. Maly ed., 2d ed. 2012) (citing Royer v. Carter, 233 P.2d 539 (Cal. 1951)).

[176] There is some confusion about whether post-breach carrying costs are compensable. Some courts say that they are not. *See, e.g.*, Rowan Constr. Corp. v. Hassane, 549 A.2d 1085,

comprise only the *additional* expenses that the seller incurred as a result of the breach. For instance, assume the original buyer signs a contract to purchase the property on Day 1, with a closing scheduled on Day 90. On Day 60, the buyer breaches the contract. The seller resells the property on Day 90, with a closing scheduled for Day 120. The seller is only entitled to damages for the extra thirty-day period between the original closing date and new closing date, not the full 120 days.[177]

Despite this, courts and litigants often assume that buyers are responsible for all seller expenses, calculated as of the date of the original purchase and sale agreement. In *Peterson v. McAndrew*, for instance, the court referred to the sellers paying "carrying costs with respect to the property because of the delay in closing . . . includ[ing] mortgage interest of $23,450; property taxes of $8836; insurance costs of $748."[178] Although not explicitly stated, these sums refer to costs incurred between April 2011 (the date of the original purchase and sale agreement) and August 2011 (the date the new buyers closed on the property).[179] Rather, the damages should only be the extra expenses incurred after the buyer's breach, that is, the additional carrying costs between July 6, 2011 (the date of breach, since no closing was ever scheduled) and August 31,

1090 (Conn. App. Ct. 1988), *aff'd*, 567 A.2d 1210 (Conn. 1990) ("The parties agree that the date of the breach was April 1, 1982, and that the fair market value of the property on that date was $305,000 . . . . The defendant cannot *also* receive the mortgage interest and tax payments he made after April 1, 1982, because the date as of which he is to be made whole is that date, the time of the breach. If the law were otherwise, the repudiating purchaser could be held liable for mortgage interest and tax payments indefinitely, depending upon when, if ever, the seller sold the property."). I would submit that post-breach carrying costs are properly attributed to the buyer as costs incurred as a result of the breach. However, this is subject to two caveats. First, these costs must be offset by the expenses saved as a result of the breach (e.g. a seller cannot claim "carrying costs" if they continued to use the property). Second, these carrying costs cannot continue in perpetuity; at some point, the damages become too remote and/or the seller would be obligated to mitigate.

[177] It would stand to reason that consequential damages in the form of carrying costs should usually be assessed using the original and new closing dates as reference points. In the example, if the buyer defaulted on Day 60 and the seller immediately resold the property and closed on Day 90 as planned, the seller would be no worse off. In fact, he would be in *the exact same position* as if the original buyer had performed—he would have closed on the transaction on Day 90. With that said, there is some confusion as to the appropriate dates from which to calculate carrying costs—with many courts using the date of the buyer's breach as the starting point for the calculation of damages. In some cases, consequential damages in the form of carrying costs may be further limited as described in footnote 176.

[178] *Peterson*, 125 A.3d at 251.

[179] Proof for this proposition is found indirectly. The court accepted that property taxes were nearly $8900. If this represented only seven weeks' worth of property taxes, this would mean the yearly property taxes were about $66,115. Publicly available information on the property indicates the yearly taxes on this property at the time were $34,773. *See 43 Rowayton Ave, Norwalk, CT 06853*, ZILLOW, https://www.zillow.com/homedetails/43-Rowayton-Ave-Norwalk-CT-06853/58819836_zpid/ [on file with *Ohio State Law Journal*]. Accordingly, it stands to reason that the sellers were claiming property taxes from April 2011 to August 2011.

2011 (the date the new purchasers closed on the property). This would have dramatically reduced the over $33,000 in carrying costs that the court considered in the damages assessment.

Moreover, courts are not clear in identifying specifically what is, or should be, recoverable when a buyer breaches a contract to purchase real estate. For example, courts (and parties) often refer to "mortgage payments" being recoverable by an aggrieved seller. One court in Alabama, for instance, has explicitly stated that the "entire mortgage payment is a proper measure of consequential damages" in a real estate transaction.[180] It is only mortgage interest, however, that is recoverable.[181] Mortgage principal, which represents equity in the real property, is not a loss that is chargeable to the buyer. That litigants and courts fail to understand this basic premise is concerning, and results in buyers being held responsible for "losses" that do not exist.

3. *Other Consequential Damages: Commissions, Seller Deposits, and Idiosyncratic Harm*

Courts often lay certain expenses at the feet of buyers that are questionable. For instance, courts sometimes refer to the seller's realtor fees as potential damages that a buyer owes when he breaches a contract to purchase real estate.[182] Typically, the contract between the seller and his agent will provide that a 6% (or so) commission is due when the agent procures a buyer who is ready, willing, and able to complete the transaction.[183] This is interpreted to mean that a seller owes an agent commission once a contract is signed, or once all contingencies are removed.[184] In most contracts, agents agree to defer their

[180] Chase v. Holt, 752 So. 2d 498, 499 (Ala. Civ. App. 1999) (noting that "the entire mortgage payment is a proper measure of consequential damages" in a real estate transaction).

[181] Kulakowski v. Leavitt, No. 9364, 1996 WL 598769, at *4 n.5 (Mass. Dist. Ct. Oct. 8, 1996) ("The trial judge listed in his findings the various expense items alleged as losses by [the seller]. With respect to [the seller's] mortgage payments, only the portion representing interest and carrying costs, rather than principal, may be considered.").

[182] *See* Smith v. Knight, 42 S.E.2d 570, 570 (Ga. Ct. App. 1947) ("When the defendant refused to comply with his contract to purchase the property and the plaintiff paid the broker his commissions, the plaintiff was then entitled to maintain an action against the defendant for damages for a breach of the contract in the amount of the commission so paid by him, this being the amount that he had been endamaged."); *see also* Stephenson v. Butts, 142 A.2d 319, 322 (Pa. Super. Ct. 1958) ("[T]he defendants should not profit from their breach and, if plaintiffs are obligated to pay an additional commission on the resale of this property at $15,500, such commission should be borne by defendants.").

[183] Barwick et al., *supra* note 18, at 219 ("Compared to other industrialized countries, commission fees in the United States are high. For example, commission rates average less than 2 percent in the United Kingdom and the Netherlands, compared to the typical rates of 5 percent and 6 percent in the United States . . . .").

[184] Margaret H. Wayne Tr. v. Lipsky, 846 P.2d 904, 910 (Idaho 1993) (citing Rogers v. Hendrix, 438 P.2d 653 (Idaho 1968)) (referencing the "traditional rule that a broker earns his

commission until the seller receives the purchase price at closing.[185] Some contracts also provide that, in the event of a default by a buyer, the seller's agent will be entitled to half of the buyer's deposit in lieu of his commission.[186]

One might question whether an agent's commission, earned pursuant to a private contract between the seller and his agent, is a legitimate head of damage. It is unclear that a buyer would have in his contemplation that a seller would owe commission to his agent for a failed real estate transaction.[187] One personal financial and tax advisor asks, "Have you ever considered the possibility that you might have to pay a sales commission even if you do not sell your house?" and then answers, "Most people, I would wager, have never heard of such a thing, yet it probably happens more often than we might guess."[188] A buyer would probably believe that a commission is earned when the deal actually closes. Given that the property will likely go back on the market, the buyer will assume that the commission will eventually be earned (just at a later time). At most, the buyer would expect to be liable for additional expenses in the interim, but not a full commission. Otherwise, the agent will end up earning double commission—one for the failed transaction, and one for the eventual sale.[189] Proof that a buyer would not have in their contemplation the possibility of paying a 6% commission on an uncompleted real estate transaction can be found in looking at the reaction of *agents* to this proposition. On a popular real estate

commission when he procures a buyer who is ready, willing and able to purchase on terms acceptable to the seller").

[185] *See, e.g.*, *Real Estate Sale Agreement*, U.S. SEC. & EXCHANGE COMM'N, https://www.sec.gov/Archives/edgar/data/1438897/000143889709000021/exhibit101.htm [https://perma.cc/773P-RHJ5].

[186] *See, e.g.*, Hopkins-Easton & Assocs. v. Santana Props., Inc., 557 So. 2d 70, 71 (Fla. Dist. Ct. App. 1990) ("The broker produced a buyer who signed a contract with the owner calling for a purchase price of $3,800,000.00 with a $150,000.00 deposit. In the event of default by the buyer, one-half of the deposit was to be retained by the owner and one-half was to be awarded to the broker.").

[187] Consequential damages are those that are in the contemplation of the parties as being a probable result of a breach at the time the contract is entered into. It is fairly rare for an agent to sue his seller when the deal does not close, but it happens. *See* Sean O'Shea, *GTA Real Estate Broker Demands Commission Even After Failed House Sale*, GLOBAL NEWS (Sept. 6, 2018), https://globalnews.ca/news/4431658/real-estate-broker-demands-commission-gta/ [https://perma.cc/7JFB-RM3Z] (recent Canadian case where broker originally demanded over $45,000 from seller when buyer failed to close transaction).

[188] Larry M. Elkin, *Why Homeowners Are Paying a Sales Commission Even Without a Sale*, BUS. INSIDER (May 10, 2011), https://www.businessinsider.com/paying-sales-commissions-without-a-sale-2011-5 [https://perma.cc/22VA-EV73].

[189] *See id.* ("Of course, if the agent subsequently finds another buyer, the agent gets another commission—and is thereby paid twice for selling the same house."). This creates a serious conflict of interest in that an agent can benefit more from having a sale fall through than having a sale completed. *See Hopkins-Easton & Assocs.*, 557 So. 2d at 71 (court awarded seller's broker two commissions for selling the same property: first, $75,000, half of the earnest money deposit that Buyer #1 forfeited, and second $216,000, which represented 6% of the price that Buyer #2 ultimately paid for the property).

website, many agents react with surprise and skepticism about earning a commission on a "sale" that never happened.[190]

While some courts allow an agent to collect his commission on a failed real estate contract, others do not.[191] For instance, in *Ellsworth Dobbs, Inc. v. Johnson*, the court held that, despite language in the contract to the contrary, the seller's agent earned his commission only when the transaction closed.[192] The court in *Ellsworth* held that it would be unfair to permit an agent to recover a commission simply because he produced a buyer who agreed to enter into a contract with the seller.[193] It emphasized that one cannot ignore what is the fundamental intention of the parties: "that the owner will sell and the buyer will pay, and the broker will thus earn his commission out of the proceeds."[194] If a transaction does not close, the agent does not earn his commission; this is simply "a normal incident of the brokerage business."[195] The court in *Ellsworth* took a commonsense approach to the issue, and one that reflects the reality of sellers' and agents' expectations. If a seller and agent should not have a reasonable

[190] *Earnest Money Disposition upon Buyer Default*, TRULIA, https://www.trulia.com/voices/Home_Selling/Earnest_Money_Disposition_upon_buyer_default-9346 [https://perma.cc/35J3-R6HS] ("I've never heard of that before. The earnest money belongs to the seller or the buyer. The listing agent gets paid when the sale of the home closes. If the sale does not close, the listing agent doesn't get paid!"; "I am also not clear why the agent would get paid at all just because the buyer backed out without good cause. I would think that the property would just go back on the market until the end of the listing agreement as falling out of contract normally does not automatically terminate the listing agreement."; "Here in California I've never heard of an agent getting commission because of a default by either party. One can ask but they are on shaky ground."); *see also Are Commissions Still Owing from Sales that Did Not Close?*, SILICON VALLEY L. GROUP, https://www.svlg.com/are-commissions-still-owing-from-sales-that-did-not-close.html [https://perma.cc/5UFP-UEVH] ("These case rulings may seem counterintuitive to the intent of the buyer or seller to pay commissions only upon a completed transaction of purchase and sale.").

[191] *See, e.g.*, Margaret H. Wayne Tr. v. Lipsky, 846 P.2d 904, 910–11 (Idaho 1993).

[192] Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843, 855 (N.J. 1967) ("When a broker is engaged by an owner of property to find a purchaser for it, the broker earns his commission when (a) he produces a purchaser ready, willing and able to buy on the terms fixed by the owner, (b) the purchaser enters into a binding contract with the owner to do so, and (c) the purchaser completes the transaction by closing the title in accordance with the provisions of the contract.").

[193] *Id.* at 852.

[194] *Id.* at 855; *see also id.* at 853–54 ("A lucid and realistic explanation of the relationship between an intending vendor of real property and the broker appears in the opinion of Denning, L.J. in *Dennis Reed, Ltd. v. Goody*, 'When a house owner puts his house into the hands of an estate agent, the ordinary understanding is that the agent is only to receive a commission if he succeeds in effecting a sale; but if not, he is entitled to nothing. That has been well understood for the last 100 years or more. The agent in practice takes what is a business risk: he takes on himself the expense of preparing particulars and advertising the property in return for the substantial remuneration—reckoned by a percentage of the price—which he will receive if he succeeds in finding a purchaser.'" (citations omitted)).

[195] *Id.* at 855.

expectation that commission will be owed absent an actual sale, then neither should the buyer have such an expectation. Thus, it is questionable whether it is appropriate to consider an agent's commission as "damages" that the buyer should have in his contemplation.

Courts have sometimes referenced as damages the potential loss to a *seller* of his deposit on purchase of a separate property.[196] Oftentimes, when a seller sells property, he is also simultaneously buying another property, and will put down a deposit on this property.[197] If the seller is not able to fulfill this contract, and thus loses his deposit, then courts have considered the seller's forfeited deposit as damages that the original buyer should be responsible for.[198] Whether this is a proper consideration in the damages calculation likely turns on the specific facts of the case. When did the seller purchase his new property?[199] Did the buyer know that the seller was buying another property? If so, what was the buyer's understanding of the financing involved? The reason these questions are important is because recovery for consequential damages is limited by the principle of foreseeability: was it foreseeable to a buyer that a seller would lose his deposit on a separate property transaction as a probable result of the buyer's breach?[200] Unfortunately, courts rarely look at what a buyer knew, or should have known, about potential seller losses at the time the contract is entered into.

Courts often list other questionable "damages" as supporting the conclusion that a buyer must forfeit his deposit.[201] One author argues that in upholding the

[196] *See* Parker v. Knauf, No. CV085007670, 2010 WL 1375564, at *6 (Conn. Super. Ct. Mar. 3, 2010) ("The defendants and their real estate agent were aware that the plaintiffs were purchasing a condominium in the area as well as a property in Florida. The extended date for closing the Point O'Woods property was chosen specifically to coincide with the plaintiffs closing on the Florida property on the following day, January 23, 2008. The contract for the Florida property also had a liquidated damages clause which would subject the plaintiffs to the loss of their deposit of $225,500 if they failed to timely close. The risk to them was significant.").

[197] I suspect that courts validate many liquidated damages clauses because of a concern that the buyer's breach could have catastrophic domino effects in terms of the seller's purchase of a new property.

[198] *See, e.g.*, *Parker*, 2010 WL 1375564, at *6 ("The contract for the Florida property also had a liquidated damages clause which would subject the plaintiffs to the loss of their deposit of $225,500 if they failed to timely close. The risk to them was significant.").

[199] If the seller purchased the new property prior to selling their house, then it is questionable whether the loss of the seller's deposit, or the inability to purchase the new property, ever could be attributable to the buyer.

[200] GREENWALD & BANK, *supra* note 166, at Ch. 11-C 11:116 ("[C]onsequential damages are losses not arising 'directly and inevitably' from similar breach of similar agreement, but 'secondary and derivative' losses arising from circumstances particular to subject contract or parties . . . . Such damages are recoverable if the circumstances from which they arise were *actually communicated to or known by* the breaching party (a subjective test), or were matters of which the breaching party *should have been aware* at the time of contracting (an objective test)." (emphasis in original)).

[201] For example, in *Peterson*, the court indicated that the seller's damages included over $5000 for lost interest on the seller's principal (at a rate of 2.25%), which was tied up an

forfeiture of a deposit as a valid liquidated damages clause, a number of courts point to "theoretical," "noncompensable," or "idiosyncratic harm."[202] For instance in *Wallace Real Estate v. Groves*, the trial court took issue with the seller's characterization that there had been no damage, stating:

> To argue that there is no damage—When this property has been held up for almost two years, when during that two-year period of time the property has been unmarketable, the sellers have grown older, have spent two precious years of their lives without 1.58 million dollars, or whatever the sale price was, to say that their having had to deal with lawyers and the insinuations and the inconvenience of litigation for a two-year period of time is not a damage?[203]

That which the court in *Wallace* characterizes as "damage" is not recognized as compensable under normal contract law principles.[204] Things like "inconvenience," "having . . . to deal with lawyers," and "grow[ing] older [without the contracted-for money]" are simply irrelevant to the measure of damages in a breach of contract action.[205]

extra seven weeks because of the buyer's breach. Peterson v. McAndrew, 125 A.3d 241, 252 (Conn. App. Ct. 2015). In order for the $5000 to be a legitimate measure of damages, this would have to mean that the seller had over $2 million in equity in the property. But the seller also claimed as damages "mortgage interest" in the amount of over $23,000 for that seven-week period. It does not seem feasible that the seller could recover *both* for lost interest on principal, as well as mortgage interest; the two appear to be inconsistent given the above facts.

[202] Olazábal, *supra* note 19, at 540.

[203] Wallace Real Estate Inv. v. Groves, 881 P.2d 1010, 1018 (Wash. 1994) ("[The] payments were intended to compensate the sellers for freezing the purchase price at a time when real estate land values were escalating at unprecedented rates; compensating seller for holding the property off the market and losing the time value of its property were the property liquidated and funds invested; lost opportunity for larger profits; and related costs."); *see also* Watson v. Ingram, 881 P.2d 247, 251 (Wash. 1994) ("The $15,000 earnest money deposit represented several variables, including the value of the improvements [the seller] was required to make under the contract, fluctuations in the real estate market, and lost value of the use of the net sale proceeds prior to the eventual sale of the property. Each of these variables represents a significant potential loss to [the seller] in the event of a breach by [the buyer]. In addition, [the seller] was specifically interested in a quick sale because he was attempting to relocate to California as soon as possible. The liquidated sum may have, in part, reflected the personal cost to [the seller] of a delay in the sale date.").

[204] The court in *Wallace* laments the "unduly restrictive" approach to actual harm in the real estate context: "A further concern with requiring proof of actual damage is that legal definitions of actual harm can be unduly restrictive, especially in the context of real estate transactions. The standard loss-of-bargain measure fails to compensate sellers for allowing potential buyers to hold salable property off the market before closing . . . ." *Wallace Real Estate Inv.*, 881 P.2d at 1016 (citation omitted); *see also* Holly Hill Real Estate v. Raskopf, No. FSTCV030194525, 2006 WL 410149, at *2 (Conn. Super. Ct. Jan. 31, 2006) ("[T]here is a genuine issue of material fact as to whether they incurred any damages as a result of the plaintiff's failure to proceed with the purchase.").

[205] *See Wallace Real Estate Inv.*, 881 P.2d at 1018. Oftentimes, liquidated damages clauses take an "everything but the kitchen sink" approach to enumerating potential losses.

4. *Expenses Saved as a Result of Buyer's Breach*

When courts are listing the damages that the seller incurred, or could have incurred, they often fail to subtract losses or expenses avoided as a result of the breach.[206] That is, if the breach ended up saving the seller money, then this amount would need to be offset against any damages. The most common way that this comes up in real estate cases is where the seller uses and enjoys the property post-breach. If the seller continues to live in the house after the buyer breaches the contract, the expenses associated with home ownership and maintenance are not chargeable to the buyer.

Despite this commonsense proposition, courts often fail to account for the seller's continued use of the property after the breach. For instance, in *Williams v. Ubaldo*, the trial court granted $3500 in damages for the property taxes paid by the sellers for the period of time between the breach and a subsequent sale.[207] The buyers argued that this was an improper head of damages given that the sellers retained possession and use of the property during this time period.[208] The appellate court agreed, stating, "There is no authority for the proposition that the avoidance of tax liability is part of the benefit of the bargain and may be included without considering corresponding financial benefits."[209] The court in *Askari v. R & R Land Co*. expressed a similar sentiment:

> The trial judge here permitted [the seller] mortgage interest expense and real property taxes from the date of breach through the date of judgment, totaling $9,194. The trial judge, however, failed to make findings that . . . these expenses were *over and above* the value of the use of the property to [the seller] during this period.[210]

One would suspect that many of these sorts of cases "fly below the radar" because courts are not clear on exactly what carrying costs they are awarding, making it difficult for buyers to litigate the issue. For instance, in *Kutzin v. Pirnie*, the court awarded $3825 for "utilities, real-estate taxes, and insurance expenses the [sellers] had incurred during the six-month period between the

See, e.g., Parker v. Knauf, No. CV085007670, 2010 WL 1375564, at *8 (Conn. Super. Ct. Mar. 3, 2010) ("The provision in the real estate contract provides some guidance for the determination of liquidated damages. It states in part that, [damages might include] '. . . costs of carrying, maintaining insuring and protecting the property; loss of interest income on the proceeds; loss of optimum market time, value and conditions; the uncertainty, delay, expense and inconvenience of finding a substitute buyer; additional commissions, fees, taxes and borrowing expenses to meet obligations entered into in anticipation of performance.'").

[206] RESTATEMENT (SECOND) OF CONTRACTS § 347(c) (AM. LAW INST. 1981) (must deduct from damages any cost or other loss avoided by not having to perform).

[207] Williams v. Ubaldo, 670 A.2d 913, 915 (Me. 1996).

[208] *Id.* at 917.

[209] *Id.*

[210] Askari v. R & R Land Co., 225 Cal. Rptr. 285, 289–90 (Ct. App. 1986).

originally anticipated closing date and the date of actual sale."[211] It seems, however, that the sellers continued to live in the home during this time period.[212] Given that the sellers derived benefit from the buyer's breach (i.e., they were able to live in their home), the court should not have awarded any of these damages to the sellers.[213]

The failure to account for costs and expenses saved as a result of the breach results in an erroneous calculation of damages. Since damages appear higher than they actually are, this lends support to the forfeiture of the deposit as a reasonable liquidated damages amount.

5. *Case Study:* Parker v. Knauf

As discussed, courts rarely undertake a comprehensive examination of damages—actual or prospective—in evaluating the enforceability of liquidated damages clauses in the real estate setting. In their reasoning, they often overstate the damage, refer to non-compensable losses, and fail to account for expenses and costs saved. The recent case of *Parker v. Knauf* illustrates the "bolstering" approach to damages which tends to be common in liquidated damages cases.[214]

In *Parker*, the court ordered the buyers to forfeit a sum of approximately $290,000 (plus over $85,000 in attorneys' fees) because they breached a contract to purchase the seller's home.[215] The buyers had agreed to purchase the seller's property for approximately $2.9 million in September 2007.[216] Because the buyers were ultimately not able to secure adequate financing, the seller declared them to be in default on February 19, 2008.[217] The seller immediately re-listed the property and accepted a new offer to purchase the property for $2.8 million just four weeks later.[218] The transaction closed shortly thereafter, in May 2008.[219]

The buyers seemed to concede that the seller's expectancy loss was approximately $100,000, the difference between the original contact price and the resale price.[220] However, while the resale price may have been relevant to determining market value, it should not have been determinative. The question

[211] Kutzin v. Pirnie, 591 A.2d 932, 935 (N.J. 1991).

[212] *Id.*

[213] *See* Rogers v. Lockard, 767 N.E.2d 982, 994 (Ind. Ct. App. 2002) (the sellers claimed that their damages consisted, inter alia, of lease payments on a new property as well as expenses associated with maintaining the home that the buyers had promised to purchase; sellers failed to recognize that *both* are not recoverable); *see also* Brief for Appellees at *6, Rogers v. Lockard, 2001 WL 35814949 (Ind. App. 2001) (No. 32A04-0107-CV-307).

[214] *See generally* Parker v. Knauf, No. CV085007670, 2010 WL 1375564 (Conn. Super. Ct. Mar. 3, 2010).

[215] *See id.* at *17.

[216] *Id.* at *1–2.

[217] *Id.* at *3.

[218] *Id.* at *4.

[219] *Id.*

[220] *Parker*, 2010 WL 1375564, at *8.

is what the property was worth on February 19, 2008, the date of the buyer's breach. By all accounts, this property was in high demand. Originally, there were multiple offers on the house, some for over asking-price.[221] And, when the property was re-listed, it sold within a couple of weeks.[222] It could be that the sellers, in an effort to finally be "done" with the house, accepted an offer that was under market value.[223] None of this analysis appears in the case. The court assumes, as does the buyer, that the seller lost $100,000 because of the breach.[224]

Additionally, the court indicated that there were "numerous costs and bills to keep the house until the sale on May 12, 2008," noting that "[t]hese costs are substantial."[225] The court stated:

> The plaintiff testified about the costs to carry the mortgage as well as insurance, fuel oil, propane, electric, snow plowing and caretaker, phone service for the security alarm, winter service on the pool, the security system alarm, OKON, sewer fee, water charge, re-listing the house fees, lawn service to clean up before the sale and the irrigation cost, as well as the additional attorney fees as a result of the default of the parties to close.[226]

The costs are likely not as "substantial" as the court made it seem. With respect to the mortgage, the seller's losses are limited to the interest that the seller had to pay for three months.[227] The sellers had purchased the home approximately thirteen years prior for $899,000, and had presumably been paying down the mortgage during this time frame.[228] It stands to reason that three months of mortgage interest payments on this particular property were not that "substantial." Likewise, routine bills for a vacant property (electricity, water, etc.) for a couple of months would amount, at most, to a few thousand dollars. Finally, much of the work that attorneys did in preparation for closing could likely be transferrable to the new buyer. The court's extensive enumeration of what are not particularly substantial expenses served only to

[221] *Id.* at *1.

[222] *Id.* at *4.

[223] *Id.* at *4. The plaintiffs re-listed the property on February 18, 2008 for the same price as it had been listed in August 2007. *Id.* They received an offer to purchase the property in early March. *Id.*

[224] *Id.* at *8.

[225] *Id.*

[226] *Parker*, 2010 WL 1375564, at *17 n.3.

[227] *See id.* at *8. It is unclear whether the relevant time frame is three or four months. *See generally id.* The closing was supposed to be on January 22, 2008, meaning that the buyers would be responsible for four months of post-breach carrying costs. *Id.* at *2. However, the sellers did not formally declare the buyers in default until February 19, 2008. *Id.* at *3.

[228] *See 29 Point O Woods Rd, Darien, CT 06820*, ZILLOW, https://www.zillow.com/homedetails/29-Point-O-Woods-Rd-Darien-CT-06820/58779332_zpid/ [on file with *Ohio State Law Journal*].

make the seller's losses seem significant, thereby justifying the retention of an almost $300,000 deposit.

Additionally, in assessing the reasonableness of the liquidated damages clause, the court took into account the capital gains tax of $172,854 that the sellers paid when they liquidated some stock to raise funds to purchase a house in Florida.[229] The court indicated that "it is common knowledge that the sale of stock will result in some capital gains even if less than what was projected by the plaintiffs. The court cannot accept the defendants' position that it should not consider any tax consequences after the sale of the stock."[230] The court failed to recognize that, at some point, the sellers would have incurred capital gains tax when they liquidated the stock. Accordingly, it is nonsensical to put the capital gains tax on the breaching buyer.

Moreover, the court failed to consider that the sellers had at least some significant funds available to them that could have been used to purchase the new Florida property. The court noted that prior to marketing their property in the summer of 2008, the sellers "sought to diversify their stock proceeds."[231] They *chose* to use this money to purchase a condominium property in Connecticut in February 2008, rather than using it to purchase their Florida property.[232] They could also have chosen to finance the purchase of the Florida property—meaning that the buyers would be responsible, at most, for the finance charges and mortgage interest until such time that the sellers sold their property. This would surely have been far less than the over $170,000 in capital gains tax.[233]

Parker v. Knauf is emblematic of many of the deposit cases.[234] Courts make the damages, or potential damages, look sizable in order to ultimately bolster the conclusion that the liquidated amount was reasonable. Almost any amount can look reasonable when actual losses are inflated, and non-compensable losses (e.g. time, inconvenience, etc.) are added to the mix.[235]

[229] *Parker*, 2010 WL 1375564, at *8.

[230] *Id.*

[231] *Id.* at *3.

[232] *Id.* It appears that the Parkers purchased the New Canaan property for almost a million dollars. *See 205 Main St. Apt 25, New Canaan, CT 06840*, REALTOR.COM, https://www.realtor.com/realestateandhomes-detail/205-Main-St-Apt-25_New-Canaan_CT_06840_M37269-11162 [https://perma.cc/K97L-SRWC].

[233] A buyer should not be responsible for the seller's choice of the most expensive form of mitigation.

[234] *See* Peterson v. McAndrew, 125 A.3d 241, 251 (Conn. App. Ct. 2015).

[235] Sellers often take great liberties with chronicling their "losses." For instance, in *Tsiropoulos v. Radigan*, the seller listed the following as damages flowing from the breach (and therefore entitling her to retain $30,000 deposit), even though the property sold three weeks after the scheduled closing date for $5000 *more* than the original contract price: $3300 in attorneys' fees for the aborted closing (presumably, at least some of this work was transferable to the new buyer); $1658 to remove an oil tank (presumably, the extra $5000 the new buyer paid could have accounted for this benefit); $1000 that the seller lost with respect to buyer's agreement to purchase certain personal property (this fails to account for

* * *

The case law reveals certain trends concerning the enforceability of liquidated damages clauses requiring a buyer to forfeit his deposit upon breach. Courts readily enforce these clauses against buyers—often to the tune of up to 20% of the purchase price of the property. When courts do conduct an analysis of whether a given clause constitutes an unenforceable penalty, the analysis is often perfunctory and conclusory. Courts rubber-stamp the clauses because the percentage forfeited is within the accepted range in the particular geographic region and fail to actually analyze whether the clause is a penalty on the facts of the case. Additionally, courts tend to overemphasize the uncertainty factor in the liquidated damages analysis and inflate the amount of damages suffered by a seller as a result of the breach. Both of these things, in turn, serve to make the liquidated amount look reasonable.

V. THE REALITIES OF REAL ESTATE CONTRACTING

As is clear, courts take a very liberal approach to the enforcement of liquidated damages clauses that require a buyer to forfeit his deposit in a failed real estate transaction. What is largely missing from all of this, however, is a dose of realism. In the analysis of whether a buyer should have to forfeit his deposit, it is important to consider the realities of real estate contracting. The realities of real estate contracting include the following: the deposit is not truly an estimate of actual harm; buyers often do not understand what they are

the fact that seller has retained this property worth $1000); $9000 which was the difference between the buyer's offer and the next highest offer that had been on the table (this is not damage *caused* by the breach). These damages are all suspect. Nonetheless, by "upping" her losses, the seller is trying to make her retention of the $30,000 look more reasonable. *See* Tsiropoulos v. Radigan, 133 A.3d 898, 899–901 (Conn. App. Ct. 2016); Brief for Defendant-Appellee at 4, Tsiropoulos v. Radigan, 133 A.3d 898 (Conn. App. Ct. 2016) (No. 37176), 2015 WL 10945449, at *6; *see also* Schrenko v. Regnante, 537 N.E.2d 1261, 1263 (Mass. App. Ct. 1989) (sellers claiming, and court accepting, that sellers incurred out-of-pocket expenses of $10,581.62 plus $8250 in additional broker's commission resulting from the buyer's breach; this is despite the fact that the sellers sold the property for $25,000 more than the original contract price *less than one week* after the breach); Williams v. Ubaldo, 670 A.2d 913, 917–18 (Me. 1996). The plaintiffs tried to claim costs associated with repurchasing winter-related equipment and snow removal, but the court rejected claim, stating:

> It is not reasonable to conclude that the extra costs of snow removal and winter equipment are foreseeable consequences of a breach of a real estate contract in the ordinary case. People selling their homes in Maine are not necessarily in the process of moving to warmer climates: they could be staying in Maine, or moving to another northern state. There is no evidence in the record that [the buyer] was aware of the [the sellers'] plans after the sale. Neither is there any evidence that they communicated their intention to sell their winter equipment and move to a warmer climate.

Id.

signing; remedies in real estate contracts are usually lopsided in favor of sellers; buyers optimistically believe they will not breach a contract to purchase real estate; buyers rely heavily on advice from realtors, who have an inherent conflict of interest; and buyers lose "real" money when they are forced to forfeit an earnest money deposit.

A. *The Deposit Is Not an Estimate of Anticipated Harm*

Liquidated damages are intended to be a reasonable estimate of anticipated harm flowing from a breach. This should mean that the parties have turned their minds to the potential damages from a breach, estimated their probability, and negotiated a compromise whereby both parties assume some risk. Despite rhetoric in the case law to the contrary,[236] this is not how deposit/liquidated damages clauses work in the real estate context.[237] The amount deposited by the buyer, and thereby potentially forfeited, is not negotiated with a view to compensating the seller for potential losses.[238] As one court put it, "[I]n the normal transaction for the purchase of a home, the amount of the deposit is seldom truly negotiated by the parties with any thought as to whether it is a reasonable pre-estimate of the actual damages likely to be incurred in the event of a default."[239] Rather, a myriad of other factors influence how much a buyer will deposit—and potentially forfeit—in a real estate transaction.

[236] Kelly v. Marx, 705 N.E.2d 1114, 1117 (Mass. 1999) ("This approach most accurately matches the expectations of the parties, who negotiated a liquidated damage amount that was fair to each side based on their unique concerns and circumstances surrounding the agreement, and their individual estimate of damages in event of a breach."); Watson v. Ingram, 851 P.2d 761, 765 (Wash. App. 1993), *aff'd*, 881 P.2d 247 (Wash. 1994) ("The amount of the deposit represents the parties' agreement about what will serve as sufficient liquidated damages for a breach.").

[237] Sometimes, the seller unilaterally sets the deposit amount and presents the contract to the buyer for a signature. *See, e.g.*, Ne. Custom Homes, Inc. v. Howell, 553 A.2d 387, 389 (N.J. Super. Ct. Law Div. 1988) ("[Seller] acknowledges that its attorney prepared the contract for this specific property prior to any negotiations with [the buyer]. The seller's realtor inserted the purchasers' names and the purchase price.").

[238] *See, e.g.*, Braillard v. Olson, No. 44596-1-I, 2000 WL 1051932, at *2 (Wash. App. July 31, 2000) ("The parties testified that they first agreed to the sum of $87,500 as the earnest money deposit, but that the [buyers] later increased it to $200,000 in order to show the [sellers] that they were serious about purchasing the home . . . . [T]here is no evidence in the record to indicate that the increase was due to any reevaluation of potential damages flowing from a future breach. [The seller] also testified that when he accepted the $200,000 note from the [buyers] as earnest money, he did not think about any damages [he] might incur if the sale did not go through . . . . Although there is no requirement in the law that one specifically discuss losses that might occur in the event of a breach, the candid admission that [the seller] did not even think about liquidated damages is telling.").

[239] Margaret H. Wayne Tr. v. Lipsky, 846 P.2d 904, 909 (Idaho 1993).

Probably the most important factor in determining the deposit amount is the "going rate" in the local area and the recommendation of the realtor.[240] Although difficult to verify, it is likely that buyers will simply do whatever their realtor tells them is the necessary next step in the home buying process. If it is standard practice for a buyer to put down a 5% deposit, and that is what their realtor recommends, then the buyer will probably put down a 5% deposit. Though anecdotal, when I was purchasing a house a few years back, my realtor told me I needed to write a check for 5% of the purchase price of the house—so I did. No questions asked. Although it is possible that my experience is not representative, I strongly suspect that it is. Buyers are simply shepherded through the buying process by a realtor who tells them the amount they "need" to put down as a deposit.

This deposit number (3%, 5%, 10%, or whatever) is just a random number. It is not usually reflective of market trends or the particular circumstances of the transaction. Importantly, it rarely bears any relationship to the anticipated actual harm that could result from a buyer's breach of contract. In other words, the deposit is not an attempt to liquidate damages—it is just an arbitrary number chosen for reasons unrelated to potential harm. How do we know this?

First, as indicated above, the amount of the buyer's deposit is usually determined (or at least heavily influenced) by the buyer's realtor. The realtor has an inherent conflict of interest here. Ultimately, the realtor wants to make the sale, and thereby earn a commission. All things being equal, it is more likely that the seller will accept an offer with a higher deposit. It stands to reason that a realtor has every incentive to recommend to a buyer that he put down at least the industry norm in order to ensure that the deal is consummated. The realtor's (and the buyer's) assumption at this point is that everything will go according to plan and the purchase will be completed. So there is no downside, from the realtor's perspective, to recommending a certain deposit amount. The realtor's role in setting the deposit, coupled with an inherent conflict of interest, demonstrates that deposits in real estate contracts are not a function of the parties' assessment of prospective harm.

Second, the deposit number tends to be static across time. For instance, if the standard deposit in Massachusetts is, say, 5%, then that number does not change across time and markets. There are cases decided years (or decades)

[240] Cornett, *supra* note 36 ("If you're working with a real estate agent, he/she should be able to tell you what the norm is for your area and price range. Ask your agent how much of an earnest money deposit you should pay, for the type of property you seek. Stick to the local norm as much as possible, to avoid losing the home to a stronger buyer/offer. If you try to make a deposit that is well below average for your area (and below what the homeowner is *expecting*), they might not take you seriously."); *All About Earnest Money Deposits*, ZILLOW, https://www.zillow.com/mortgage-learning/earnest-money-deposits/ [https://perma.cc/7MTU-J6MP] ("But to an anxious seller, an earnest money deposit provision below local norms can cause questions about your level of commitment and/or strength as a buyer.").

apart saying that x% is a reasonable assessment of harm.[241] Given that the real estate market is continually fluctuating, if the number were an attempt to assess prospective harm, one would expect the number to change over time, and based the condition of the local real estate market.

Third, and related to the above, deposits tend to be higher in competitive markets.[242] That is, where the market is "hot" and there are multiple offers on a piece of property, buyers will often attempt to distinguish themselves by agreeing to a higher deposit.[243] For instance, if the normal deposit amount is 5%, a buyer might offer 10% as an incentive for the seller to accept his offer. Yet, it is precisely in a competitive or rising market that the seller's potential damages are likely to be zero. The fact that buyers are often willing to deposit, and thereby forfeit, more money in cases where a seller is likely to suffer no damages demonstrates that the deposit amount is not intended to be a number that represents the parties' attempt to estimate harm.

Fourth, the buyer and seller rarely negotiate the deposit amount in reference to anticipated harm. Certainly, the parties can, and do, bargain over how much of a deposit the buyer will provide; however, the number is normally discussed in the abstract, and not in regard to potential losses that the seller might incur if the buyer defaults. Additionally, the buyer is not generally aware of the particulars of the seller's circumstances, thereby enabling the chosen deposit

[241] *Compare* Parker v. Knauf, No. CV085007670, 2010 WL 1375564, at *6 (Conn. Super. Ct. Mar. 3, 2010) (valid liquidated damages clause where deposit was ten percent of the purchase price), *with* a case decided twenty years prior, Vines v. Orchard Hills, Inc., 435 A.2d 1022, 1029 (Conn. 1980) (noting a presumption of validity that attaches to a clause liquidating the seller's damages at ten percent of the contract price).

[242] David Myers, *Common Earnest-Money Deposit Mistakes that Some Buyers Make*, DAILY HERALD (Mar. 17, 2017), https://www.dailyherald.com/article/20170317/entlife/170319269/ [https://perma.cc/C9DD-6HLG] ("Most of the time, it's an amount that's equal to 1 or 2 percent of the purchase price. But today (especially in red-hot markets), it's not unusual to see buyers offering a deposit that's equal to 5 percent or even 10 percent of the sale price."); *All About Earnest Money Deposits*, *supra* note 240 ("Earnest money deposits are usually 1 percent to 3 percent of a home's purchase price, depending on local custom and the pace of current market conditions (the faster the market pace, the higher the deposit).").

[243] *See, e.g.*, Elizabeth Weintraub, *Multiple Offers-Competing Home Offers*, BALANCE (July 28, 2019), https://www.thebalance.com/multiple-offers-competing-home-offers-1798836 [https://perma.cc/54CU-MEV5] ("Sometimes homebuyers wonder if it's even worth trying to compete against other buyers in a seller's market. It's not unusual for a seller to receive 20 offers when there's very little inventory on the market. It's almost always a good idea to write an offer anyway. *Somebody* will be the winning offer. Why can't that person be you? It can if you follow some tips to sweeten the pot . . . . Submit a Large Earnest Money Deposit. Pending home sales sometimes blow up and many sellers worry that once they commit to an offer, the winning buyers might back out of the transaction or default on the contract. By then, all the other buyers have disappeared. Remember that the earnest money deposit is part of your down payment. You'll show the seller that you're serious about closing if you increase it above normal. You're only offering the seller the money now rather than later, and it speaks volumes.").

number to be reflective of prospective harm. That is, the buyer is usually not privy to details on the seller's end, such as whether the seller is purchasing another home and on what terms, what the contract between the seller and his agent provides, whether the seller is able to obtain adequate financing absent the sale, whether the seller has back-up offers, etc. Given that the buyer lacks this background knowledge, it is safe to say that the deposit amount does not reflect the parties' attempt to gauge prospective harm.

Finally, buyers and sellers do not seem to understand the purpose behind the forfeiture of the deposit, thereby lending support to the idea that the number is largely chosen at random and not as an attempt to liquidate damages.[244] Most buyers think that the reason they forfeit a deposit is simply because they have breached the contract—i.e., the forfeiture of the deposit is a penalty for breach. The logic is likely quite simple: "I signed a contract, I broke the contract, I have to pay a penalty for breaking the contract."[245] This view is reflective of the perception that breaching a contract is somehow "bad" and that a party must be punished for it.[246] Other buyers might go one step further and say that the reason for the forfeiture provision is to prevent them from breaching the contract. That is, the fact that their money is on the line is what prevents them from walking

[244] In a *Washington Post* real estate advice column, "Beth" writes, "The contract I just signed to purchase a house contained the following language: 'If the buyer defaults, the earnest money will be forfeited to the seller. This is to be considered liquidated damages and not as a penalty.' Can you please explain what this means?" Beth's experience is likely reflective of a majority of homebuyers, particularly first-time home buyers. *See* Benny L. Kass, *When It Comes to a Real Estate Contract, Be Sure You Understand What You're Signing*, WASH. POST (June 2, 2017), https://www.washingtonpost.com/realestate/when-it-comes-to-a-real-estate-contract-be-sure-you-understand-what-youre-signing/2017/06/01/773622a6-4556-11e7-bcde-624ad94170ab_story.html [https://perma.cc/VUH4-FZAK].

[245] In the first-year Contracts II class that I teach, I provided students with a series of questions about deposits in real estate contracts, prior to them studying liquidated damages, via a "1L Questionnaire." One question asked *why* we have a rule that requires a buyer to forfeit their deposit in real estate transactions. A number of students echoed the view that if you breach a contract, you should have to pay a penalty: "It is part of the contract . . . if you express intention to buy a house, the buyer should have to compensate the seller for backing out and this was in the contract."; "To punish the buyer for breaking promise; to deter people from making promises if they're not going to keep them."; "To back out of [a contract] should come with a penalty . . . . Risks are a part of life. Everyone should take due diligence before making any commitment and even when that is done, accidents inevitably happen which still require culpability. Keeping a deposit is that culpability."; "Because it was his fault for backing out unjustifiably."; "Because the deposit is required to show that the buyer is committed to purchasing the property and without a penalty for backing out, there is no true commitment."; "When making contracts both parties should have the intention not to breach, but if it happens there are penalties."

[246] James P. Nehf, *Contract Damages as Substitute for Full Performance*, 32 IND. L. REV. 765, 765 (1999) ("[M]odern contracts textbooks teach that there is nothing morally wrong with breaching contracts; in some instances it may even be economically efficient to breach.").

away.[247] This view of the deposit as a breach deterrent is simply just another way of describing a penalty.

Although difficult to definitively know what buyers think the purpose of the deposit is, the view of a deposit as a penalty is certainly prevalent. For instance, a real estate agency called "Buyers Brokers Only" claims that it only represents buyers, and that each of its brokers is also a lawyer.[248] It describes the purpose of a real estate deposit as follows: "The purpose of the deposit(s) in a contract to purchase and purchase and sale agreement is to bind the buyer to the transaction by creating a penalty for breach of contract."[249] The agency further notes that, "the deposit provides for a forfeiture provision, if the homebuyer cancels for any other reason—cold feet, change of heart, loss of employment, etc."[250] Notably, this buyer's broker agency refers to the deposit as serving to "bind" the buyer to the transaction and creating a "penalty" or "forfeiture."[251] Nowhere in its description does it say that the purpose of the deposit is to provide compensation to the seller for the harm that he may suffer in the event of a breach.[252] That a buyers-only brokerage firm views the purpose of a deposit as penalizing a defaulting buyer is likely reflective of the perception buyers have of the deposit.[253] Buyers view deposits as something that ensures they will complete the deal—not something that represents an attempt to estimate the seller's damages.

[247] This view is also echoed in the 1L Questionnaire described *supra* note 245: "To protect the seller from being taken advantage of—it is fair because it gives the buyer the incentive to act in accordance with the agreement. Buyers will not act recklessly with this rule in place."; "To encourage people following through on their promises."; "Incentive for the buyer to be sure he will close or pay."; "To hold people to their bargain."; "Because the deposit indicates a high level of certainty that the deal will go through. Most people don't have an extra $50K lying around in case their change their mind so this binds the intent of the parties as a 'sure thing.'"; "To give sellers assurance that the buyer will go through with the purchase."; "To avoid people entering into contracts that they can get out of on a technicality or that they have no intention of remaining in."; "To induce the buyer not to breach for a frivolous reason."

[248] *You Deserve True Homebuyer Representation*, BUYERS BROKERS ONLY, http://www.buyersbrokersonly.com/ [https://perma.cc/KN8R-G4P7].

[249] *Deposit v. Down Payment Explained in Massachusetts*, BUYERS BROKERS ONLY, http://www.buyersbrokersonly.com/buying/massachusetts-home-purchase-deposit-versus-down-payment [https://perma.cc/685Y-26AA].

[250] *Id.*

[251] *Id.*

[252] *See generally id.*

[253] *See, e.g.*, Parker v. Knauf, No. CV085007670, 2010 WL 1375564, at *6 (Conn. Super. Ct. Mar. 3, 2010) ("[T]he realtor that represented the defendants was not aware of what a liquidated damage clause was until she was involved in this litigation . . . .").

B. *Buyers May Not Understand the Contract They Are Signing, Including the Deposit Provision*

As a lawyer, it is easy to say that a buyer should read and understand every provision in a contract, particularly one as significant as a contract to purchase real estate. But, the reality is that buyers rarely read the contracts they sign, and a contract to purchase a home is no exception.[254] Even if buyers were to devote the time and energy to reading through a purchase and sale agreement, it is unlikely that they would understand it. They would likely be aware of the broad contours of the agreement (e.g. price, closing date, deposit amount, mortgage contingencies, etc.), but certainly not the minutia.

One author writes, "[E]ven the unsophisticated buyer of residential housing expects that he will lose the deposit actually made if he does not go through with the deal."[255] This may be true—though I would venture to guess that there is some significant percentage of buyers who do not realize that they will lose their deposit in the event they breach the contract. Purchase and sale agreements are usually standard form agreements, consisting of multiple pages of legalese. To an unsophisticated buyer, it would be difficult to understand how the contract is supposed to work by simply looking at the contract in isolation. Moreover, the provisions related to deposits tend to be buried in the agreement and/or worded in such a way that it is often unclear that a buyer will forfeit his deposit if he breaches. The standard form used by the Rhode Island Association of Realtors illustrates this problem. On that form, Section 5 on the first page provides:

> DEPOSITS. All deposits shall be held in an escrow account by the Listing Brokerage Firm named in Section 18, unless mutually agreed otherwise by Buyer and Seller, and applied to the Purchase Price, except as otherwise provided. (a) The release of all deposits shall be upon execution of a written release by Buyer and Seller or as otherwise provided in Commercial Licensing Regulation 11. (b) In the event of a dispute between Seller and Buyer as to the performance of any provision of this Agreement, the holder of the deposits shall transfer the deposits to the General Treasurer of Rhode Island after 180

[254] Amy J. Schmitz, *Pizza-Box Contracts: True Tales of Consumer Contracting Culture*, 45 WAKE FOREST L. REV. 863, 878 (2010) ("[C]onsumers have become accustomed to not reading contracts due to limited access, time, and ability to negotiate contract terms. Consumers generally assume that they lack power or contracting choices."); Debra Pogrund Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 655 (2009) ("Although . . . courts generally expect consumers to read and understand the contracts they sign and sometimes penalize the 'negligent' person for failing to do so, in reality . . . a large percentage of consumers do not carefully read the contracts they sign.").

[255] CAL. LAW REVISION COMM'N, ANNUAL REPORT: RECOMMENDATIONS RELATING TO LIQUIDATED DAMAGES 2148 (Dec. 1975).

> calendar days from the date of the original deposit, in accordance with the above regulation.[256]

On the fourth page of the standard form, Section 19 covers "Default":

> Upon default by Buyer, Seller shall have the right to the Deposits in accordance with Section 5, such right to be without prejudice to the right of Seller to require specific performance and payment of other damages, or to pursue any remedy, legal or equitable, which shall accrue by reason of such default. If Seller defaults in the performance of this Agreement, Buyer shall have the right to the Deposits in accordance with Section 5, and Buyer may pursue any and all remedies available at law or equity, including but not limited to specific performance. All disputes between Buyer and Seller over the disposition of the Deposits shall be governed by Section 5.[257]

Accordingly, to actually understand what happens to a buyer's deposit, one would need to read Section 5 in conjunction with Section 19, even though only the former is entitled "Deposit" and Section 5 does not reference Section 19. Additionally, Section 5 references a separate 29-page regulation, Commercial Licensing Regulation 11.[258] Finally, Section 19 contains the standard legalese that so many people find indecipherable: "without prejudice"; "legal or equitable remedy"; "shall accrue"; and "disposition."[259] The point is that purchase and sale agreements are not written in such a way that a buyer readily understands that he will forfeit his deposit if he breaches the contract.[260]

Empirical research has shown that consumers are woefully unaware of how remedies work in real estate contracting. The authors of *Dysfunctional Contracts and the Laws and Practices that Enable Them: An Empirical Analysis* conducted a "Remedies Experiment" whereby they sought to ascertain "how well laypersons in fact understand" limitation of remedies clauses in contracts to purchase real estate.[261] The authors assigned one group to a fair remedies clause, where both parties reserved all rights and remedies in the event of a breach.[262] They assigned a second group to a "clearly unfair" remedies clause, where the buyer's sole remedy for a seller's breach was the return of his deposit

[256] R.I. ASS'N OF REALTORS, *supra* note 51, at 1.

[257] *Id.* at 4.

[258] *See* ST. R.I. & PROVIDENCE PLANTATIONS DEP'T BUS. REGULATION, COMMERCIAL LICENSING REGULATION 11, http://www.dbr.ri.gov/documents/rules/comm_licensing/Commercial_Licensing_Regulation_11.pdf [https://perma.cc/RML2-DJCJ].

[259] R.I. ASS'N OF REALTORS, *supra* note 51, at 4.

[260] A more recent version of the Rhode Island form actually has three sections covering deposits: Section 5 (Deposits), Section 6 (Deposit Disputes), both on page one, and Section 22 (Default), on page five, sandwiched between "Notice" and "Assignment." R.I. ASS'N OF REALTORS, SINGLE FAMILY PURCHASE AND SALES AGREEMENT FORM #1401 1, 5 (2014).

[261] Debra Pogrund Stark et al., *Dysfunctional Contracts and the Laws and Practices that Enable Them: An Empirical Analysis*, 46 IND. L. REV. 797, 798–99, 846 (2013).

[262] *Id.* at 806.

and seller's remedy for a buyer's breach was the retention of the deposit.[263] Finally, they assigned a third group to a "vaguely unfair remedies clause," where the buyer's sole remedy was limited to the return of his own deposit, but the clause did not expressly state that this occurred in the case of the seller's breach.[264] The authors concluded that:

> The results of this Remedies Experiment reflected a *profound misunderstanding* of the impact of the two *unfair* remedies clauses with, for example, 64% in the *clearly unfair* condition and 68% in the *vaguely unfair* condition mistakenly believing they could still seek specific performance if the seller breached the contract, and 54% in the *clearly unfair* condition and 60% in the *vaguely unfair* condition mistakenly believing that they could recover certain out-of-pocket expenses in the event of the seller's breach.[265]

The authors also note that "even after carefully reviewing limitation-of-remedies clauses, a very large percentage of laypersons believed they were entitled to remedies that were 'clearly' (at least to an attorney or judge's eyes) excluded in the contract clause."[266] While the Remedies Experiment was not directed specifically at whether buyers understood that they forfeit their deposit in the event of a breach, the results do show that to laypeople there is a profound disconnect between what the contract *says* and what a nonlawyer *believes it says*.[267]

C. *Remedies in Real Estate Contracts Are Often Lopsided*

Although this may be changing, purchase and sale agreements tend to provide better remedies for sellers than they do for buyers. As discussed in detail above, sellers are likely to have a provision in a contract that allows them to keep the deposit in the event of breach. They may also attempt to preserve their right to pursue actual damages, in lieu of liquidated damages. Finally, they may

[263] *Id.* at 806–07.
[264] *Id.*
[265] *Id.* at 846 (emphasis added).
[266] *Id.* at 799.
[267] *See* Stark et al., *supra* note 261, at 803–04 (discussing Braunstein study noting "several areas where the purchasers failed to understand basic real estate laws as applied to their deal: (i) 50[%] did not know whether their deed was a general warranty deed, a limited warranty deed, a quit claim deed, or some other type, (which impacts liability of the seller to the buyer for defects in title and encumbrances); (ii) although many knew they had taken title as joint tenants (only 22.6% did not know how they took title), almost 50% of those who knew they took as joint tenants did not know the significance of how they held title (such as rights of survivorship, which might not be what the buyers intended if, for example, it is the couple's second marriage and there are children from the first marriage); and (iii) a large percentage of buyers displayed a substantial lack of understanding of title insurance, with only 7% realizing that there were any exceptions to their policy, and over half not realizing that title insurance did not cover faulty construction, but did cover adverse legal claims to the house and land." (alterations in original) (internal citations omitted)).

seek specific performance, forcing the buyer to go through with the transaction. By contrast, buyers' remedies tend to be much more limited. According to McDonald Hopkins, a self-professed "business advisory and advocacy law firm," it is fairly typical for a purchase and sale agreement to provide that "if the closing fails to occur as the result of a seller default, the buyer, as its sole alternative remedy, can either (i) terminate the [contract] and recover its earnest money; or (ii) seek specific performance of the seller's obligations."[268]

Buyers' remedies are even more circumscribed in certain types of real estate transactions. The Remedies Experiment described above discovered that 79% of purchase agreement forms used by condominium developers in Chicago, Illinois between 2003 and 2008 contained "highly unfair, one-sided remedies." In particular, these contracts allowed the seller/developer to retain valuable remedies upon breach, while limiting the buyer's remedies to a return of his deposit.[269] Sellers may even attempt to take advantage of these limited buyer remedies by deliberately placing themselves in default in a rising market and simply returning the buyer's deposit.[270]

[268] *Does Your Purchase Agreement Have Teeth? The Importance of Buyer Remedies*, BUS. ADVOC. (Sept. 21, 2016), https://mcdonaldhopkins.com/Insights/Blog/Real-Estate-Trends/2016/09/21/Does-your-purchase-agreement-have-teeth-The-importance-of-buyer-remedies [https://perma.cc/55AG-JNFW]. Certain purchase and sale agreements do not even provide for the possibility that it might be the *seller* who breaches the contract. *See, e.g.*, MASS. ASS'N OF REALTORS, *supra* note 49 (providing seller remedies for breach by the buyer, but silent on the corresponding remedies for the buyer). For an example of a highly lopsided remedies clause, see Samson v. Trend Dev. Inc., No. 93–2–29091–8, 1997 WL 11977, at *1 (Wash. Ct. App. Jan. 13, 1997) ("If this transaction fails to close through no fault of builder/seller, entire earnest money is non-refundable, regardless of buyer's inability to obtain financing, or for any other reason, with the exception of the inability to close the contingency house at [address]. It is further agreed between the seller and buyer that it is impractical to estimate the damages that the seller will incurr [sic] if purchaser fails or refuses to complete this transaction. Purchaser and Seller agree that the earnest money deposits are a reasonable good faith estimate of damages which would occur as a result of purchaser's default. Accordingly, in the event of default of purchaser, seller shall have the election to retain earnest money as stated above or to institute suit to enforce any rights seller has. Purchaser specifically waives any right to claim that forfiture [sic] of earnest money deposit is unenforceable as a penalty or that purchaser is entitled to any refund of the earnest money based on any theory enunciated by the court in *Lind v* [sic] *Pacific Bellevue Development*.").

[269] Stark et al., *supra* note 261, at 799.

[270] *See* Goodwin v. Hole No. 4, No. 2:06-cv-00679, 2006 WL 3327990, at *4 (D. Utah Nov. 15, 2006) ("In practical effect, an unlimited right to terminate would allow [the seller] to construct its units, then either require the purchaser to buy the property as required in the contract or return the purchaser's deposit and sell the units to another. Under this rationale—after the [buyers] and [seller] worked through the entire construction process together and the [buyers] sold their current residence in anticipation of moving—[the seller] could terminate the contract and sell to another purchaser for a higher price. On the other hand, if unit 12 were only worth $100,000 upon completion, the [buyers] would still be required to purchase it for $395,000. This would create an 'option to sell' inconsistent with the other provisions of the contract. It effectively would give [the seller] the right to define the nature and extent of its performance, a result which would make its promise illusory.").

It is important to note that the return of your *own money* is not really a "remedy."[271] As Professor Pogrund Stark points out, this "obligation . . . would exist regardless of the contract clause identifying it as the buyer's sole remedy."[272] For example, if a consumer put down $5000 on the purchase of a new car, and the dealership was not able to provide the car to the consumer, *of course* the dealership would have to give the money back. The right of a buyer to restitution of money paid is not a remedy in any meaningful sense.[273] With respect to the remedy of specific performance, it "may sound good in theory, [but] as a practical matter it has several limitations."[274] Most importantly, specific performance is an equitable remedy, meaning that it is granted in the court's discretion. A court may decide not to exercise that discretion in favor of a buyer, even if the contract is clear. Additionally, in many cases, it may not be worth it for a buyer to pursue specific performance. Given the time and expense involved in going to court, buyers may choose not to wait for months and hope that a court ultimately awards specific performance.[275]

Moreover, purchase and sale agreements rarely contain liquidated damages clauses in favor of a buyer.[276] At most, the contract will provide that a buyer is entitled to damages. This, in turn, means that a buyer would need to go through

[271] *See* WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY § 10.5, at 738 (3d ed. 2000); *see also id.* § 10.4, at 734 ("[T]he buyer who seeks a refund of earnest money is arguably not relying on contract rights, but is merely asking relief from the seller's unjust enrichment.").

[272] Stark et al., *supra* note 261, at 800.

[273] *See* Port Largo Club v. Warren, 476 So. 2d 1330, 1333 (Fla. Dist. Ct. App. 1985) (limiting the purchaser's damages to the return of his deposit "render[ed] the seller's obligation wholly illusory and would permit him to breach with impunity"); Blue Lakes Apartments v. George Gowing, Inc., 464 So. 2d 705, 709 (Fla. Dist. Ct. App. 1985) (limiting a purchaser to the return of his deposit renders the seller's obligations illusory); IDEVCO v. Hobaugh, 571 So. 2d 488, 490 (Fla. Dist. Ct. App. 1990) (noting that the default clause of the purchase agreement was void for lack of mutuality of remedy); *see also* Hackett v. J.R.L. Dev., Inc., 566 So. 2d 601, 603 (Fla. Dist. Ct. App. 1990) (noting that "[a] return of one's own money hardly constitutes damages in any meaningful sense").

[274] *Does Your Purchase Agreement Have Teeth? The Importance of Buyer Remedies*, *supra* note 268.

[275] *See id.*; *see also* Margaret Heidenry, *Can Sellers Back Out of a Home Sale? The 5 Times They May Bail*, REALTOR.COM (Nov. 1, 2017), https://www.realtor.com/advice/buy/can-sellers-back-out-of-a-home-sale/ [https://perma.cc/U999-VXB9] ("The problem with [pursuing specific performance] is it takes time and money for a buyer to enforce, and most home buyers don't want to wait a few years to get into a new home while their cash deposit sits in escrow. Most buyers would probably let it go . . . .").

[276] *But see* E. CONN. ASS'N OF REALTORS, *supra* note 49, at 2 ("DEFAULT: On default by either party, without the other party being in default, the party who is not in default shall have the right of: (A) Buyer Default: Seller retaining the deposit money as liquidated damages or proceeding with any other remedy at law or in equity. (B) Seller Default: Buyer reclaiming the deposit money, plus an amount equal to the deposit money as liquidated damages or proceeding with any other remedy at law or in equity.").

the hassle and expense of suing and proving actual damages in court.[277] While certainly not unreasonable, it is not as easy as simply seeking to enforce a liquidated damages clause, where the burden is on the breaching party to show why the clause should not be enforced and the money in dispute is already being held in escrow.

Accordingly, it is fair to say that there is some level of lopsidedness to the remedies afforded to an aggrieved seller versus an aggrieved buyer.[278] While remedies clauses are open to negotiation, it is unlikely that a prospective buyer will insist on a robust remedies clause.[279] There are a variety of reasons for this.[280] One reason is that buyers may not understand that they are entitled to expectancy damages, so they do not bother providing for them. When asked about expectancy damages of $10,000 in the Remedies Experiment (the difference between the purchase price and the fair market value of the home on the date of seller's breach), participants were "skeptical" that they should be able to recover such a large amount of money or that the $10,000 constituted a true loss.[281] Participants responded: "not really money I'm out, never owned the house in full," "seems not solid, by that I mean that it's hard to award buyer with theorized money," and "the seller does not have to reimburse the buyer for offering a good deal."[282] These responses are telling, and likely representative

[277] Not to mention actually collecting the money damages. In the case of a deposit, the funds are held in escrow, functioning as security for an eventual judgment.

[278] Some courts have ruled that the lopsidedness of the remedies invalidates the liquidated damages clause. For instance, in *Terraces of Boca Assocs. v. Gladstein*, the court stated:

> In the instant case, the liquidated damage provision of the purchase contract is invalid because it provided seller with the option of retaining the deposit but did not preclude seller from pursuing equitable remedies or from bringing an action at law for actual damages. In contrast, the purchase contract expressly limited buyers to the exclusive remedy of terminating the contract and receiving their deposit back.
>
> *Since there is an unreasonable disparity in remedy alternatives available to seller and buyers, the trial court correctly ruled that the liquidated damages clause was unenforceable because it lacked mutuality of obligation.*
>
> Therefore, the buyers are entitled to the return of their deposit.

Terraces of Boca Assocs. v. Gladstein, 543 So. 2d 1303, 1303–04 (Fla. Dist. Ct. App. 1989) (emphasis added).

[279] In many cases, sellers might not agree to modify the remedies clause. Stark et al., *supra* note 261, at 801 ("It should also be noted that only 35% of the attorneys reported that they were successful in negotiating a modification or deletion of highly unfair or problematic terms contained in the developer's form contract greater than 50% of the time.").

[280] For instance, a buyer may: be more concerned with other aspects of the deal, such as the purchase price or contingencies; believe that the law will protect them in the event that something goes wrong; or think that the seller will not breach, so they do not need to worry about negotiating a remedies clause.

[281] Stark et al., *supra* note 261, at 816.

[282] *Id.* at 817.

of the view of most buyers. Whatever the reason for the disparity in remedies, the fact is that sellers tend to be afforded better remedies than buyers in real estate contracts.

D. *Behavioral Theory Can Be Used to Elucidate Buyer Behavior in Real Estate Contracts*

The discussion above shows that, by and large, buyers: agree to forfeit deposits that bear no actual relationship to a seller's anticipated harm; do not understand the deposit provisions they are signing, which are buried deep within standard form contracts; and are likely to agree to lopsided remedies. Why would buyers hand over large deposits without fully understanding the ramifications, while failing to ensure adequate remedies for themselves? There are at least four reasons in behavioral theory that could explain this.

First, buyers are people—and people suffer from optimism bias.[283] Evidence shows that "people are unrealistically optimistic."[284] Accordingly, most buyers of real estate optimistically believe they will not breach a contract, rendering the deposit issue moot. Professor Eisenberg explains:

> [T]he same party will not normally expect that a liquidated damages provision will ever come into play against him—partly because he intends to perform, and partly because experience will tell him that in general there is a high rate of performance of contracts. For example, if contracts are performed at least 95 percent of the time (which observation suggests is likely), all the costs of processing the more remote applications of a liquidated damages provision would have to be taken into account, but the benefits of such processing would have to be discounted by 95 percent. The resulting cost-benefit ratio will often provide a substantial disincentive for processing every possible application of a liquidated damages provision, even if it were in fact possible to imagine every such scenario.[285]

Professor Eisenberg concludes that, "as a result, contracting parties are likely often to not even try to think liquidated damages provisions through, and are therefore unlikely to fully understand the implications of such provisions."[286]

[283] Hillman, *supra* note 94, at 723 ("People are generally too confident. They are willing to accept too much risk based on their belief that adverse low-probability risks will not occur.").

[284] Eisenberg, *supra* note 34, at 216 ("Nearly ninety percent of drivers believe they drive better than average. Ninety-seven percent of consumers believe that they are either average or above average in their ability to avoid accidents involving bicycles and power mowers. In a study . . . in which consumers were informed of the true average risks presented by bleach and drain cleaner, only 3 percent of consumers considered their homes to present an above-average risk . . . .").

[285] *Id.* at 227 (citations omitted).

[286] *Id.*

Second, this optimism bias combines with the "availability heuristic" to make buyers underestimate the risk that a liquidated damages clause will operate against them. The availability heuristic refers to the idea that people give more prominence to immediate events and experiences in evaluating a specific issue.[287] As such, "[t]he availability heuristic may lead a contracting party to give undue weight to his present intention to perform, which is vivid and concrete, as compared with the abstract possibility that future circumstances may compel him to breach."[288]

Third, studies show that "[p]eople prefer certainty over ambiguity and make choices to avoid uncertainty. They choose certain results over gambles, even when the latter are superior based on the law of probability."[289] Accordingly, since buyers would rather "know where they stand" rather than face low-probability, but unknown, risks, they choose to enter into disadvantageous liquidated damages clauses.[290]

Finally, people are able to "accumulate, understand, and process only a limited amount of information about the future" and as such "may fail to comprehend and focus on the prospect of breach."[291] Given how many moving parts there are to real estate transactions (inspection, mortgage, appraisal, title,

[287] *Id.* at 220–21 ("When an actor must make a decision that requires a judgment about the probability of an event, he commonly judges that probability on the basis of comparable data and scenarios that are readily available to his memory or imagination. This heuristic leads to systematic biases, because factors other than objective frequency and probability affect the salience of data and scenarios, and therefore affect the ease with which an actor imagines a scenario or retrieves data from memory.").

[288] *Id.* at 228.

[289] Hillman, *supra* note 94, at 724 (citations omitted).

[290] That people prefer certainty, even if paying actual damages is only a remote possibility, was very clear from the 1L Questionnaire described in note 245: When asked why students would prefer Option A (forfeiting 10% of the purchase price) rather than Option B (paying actual damages), student gave the following rationales: "Risk averse"; "I think I would prefer option A because even though you might lose a lot of money, at least it is clear how much is at risk going into the agreement."; "The amount is predictable. You know consequences ahead of time."; "A—because you know exactly how much money is on the line in the event that you do breach."; "When I make the decision to back out of the sale and purchase agreement, I am aware of what the total cost of doing so is."; "It generates a more consistent amount"; "Option A because it's a predictable sum that I know ahead of time. It's easier to know going into a contract that if you breach for whatever reason, you are only responsible for a predetermined sum . . . ."; "I prefer option A because in that case everyone knows what the set cost for a breach is. Option B is a bit too open ended . . . ."; "Option A . . . it is a safer bet not to take the risk of a huge actual damages award."; "Option A . . . I would rather know up front and try to negotiate the clause rather than them (seller) sue for an unknown amount."; "As a buyer I would choose Option A. With this option there is a clearly defined amount of money I would be obligated to forfeit. With option B the buyer is at the mercy of whatever the actual losses accrued by the seller are."; "Option A. Because I can simply use the discipline required to wait to put a down payment on a house until I am positive I can follow through without breaching.'"

[291] Hillman, *supra* note 94, at 731.

etc.), buyers may discount the necessity of turning their attention to what they believe is a very remote possibility.

If it is true that buyers are unduly optimistic and tend not to assimilate the seemingly remote prospect of breach into their calculus, then at least part of the rationale for automatically enforcing liquidated damages clauses is undermined. These clauses are not the product of rational, deliberate forethought. Liquidated damages clauses are largely overlooked by buyers because buyers believe that they will not matter—the deal will be consummated as planned, and the deposit amount will simply be credited to the purchase price. The idea of losing out on a house *and* thousands of dollars does not even register as a possibility.

E. *Buyers Lose "Real" Money When They Forfeit a Deposit*

When buyers put down a deposit in conjunction with a contract to purchase real estate, they are parting with "real" money. That is, they are writing a check, wiring funds, or otherwise handing over money that they currently have to an escrow agent.[292] Oftentimes, this money represents a significant portion of a buyer's life savings.[293] It is usually in the tens, if not hundreds, of thousands of dollars. When a buyer fails to complete a real estate transaction, it is likely that he will lose all of this money.

Compare that with the situation of a seller. If a buyer breaches a contract, a seller could certainly lose "real" money. The seller may have incurred expenses in reliance on a buyer's promise that he would purchase the property. For instance, the seller may have hired a lawyer to complete underlying documentation, made idiosyncratic improvements at the buyer's request, moved out of the property in anticipation of closing, and so on. Additionally, once a buyer breaches, the seller may incur expenses associated with mitigation such as re-listing the property, maintaining the premises, etc. All of these would certainly be out-of-pocket losses for the seller.

In most cases, the actual monetary losses to the seller occasioned by a buyer's breach will be significantly less than the deposit amount. While it is difficult to work with real numbers, since deposit amounts vary wildly, an illustration might be helpful. Assume that sellers are selling their property for $800,000. Buyer puts down a 5% deposit, or $40,000. Given that 5% is in the range of reasonableness according to the vast majority of courts, it is likely that a buyer will forfeit the full amount if he breaches. Would a seller's actual out-of-pocket losses amount to $40,000, or anywhere close to that number? In most circumstances, probably not. Largely administrative expenses incurred in reliance and in mitigation are unlikely to add up to tens of thousands of dollars.

[292] *See* Myers, *supra* note 242.

[293] *See* Emily Starbuck Crone, *Down Payment Reality Report*, NERDWALLET (Sept. 28, 2017), https://www.nerdwallet.com/blog/mortgages/down-payment-reality-report/ [https://perma.cc/4639-FDL9] (discussing percentage of income that different generations save for a down payment).

Usually, buyers lose more "real" money than sellers do in the event of a buyer breach.

Above, I refer repeatedly to "real" money—i.e., money that actually comes out of the pocket of either the buyer or seller. Of course, this ignores a different form of loss: the loss to the seller of the benefit of his bargain. That is, a seller expected to sell his house for $x and now the value of his property may have decreased. The law recognizes that the seller should be compensated for his disappointed expectations in the form of monetary damages.[294] These losses, however, are different in kind than the out-of-pocket losses that the seller incurs. In a sense, they may be regarded as "hypothetical" losses; the seller thought he was going to get $x for the property and now he is not.

It is not self-evident that the law should compensate a party for his disappointed expectations in the same way that it is self-evident that the law should compensate a party for his actual direct losses that are caused by a counter-party's breach. Professors Fuller and Perdue in their leading article on damages argue that "[i]t is as a matter of fact no easy thing to explain why the normal rule of contract recovery should be that which measures damages by the value of the promised performance."[295] While this Article is not the place to challenge what the law has established as the normal measure of damages—expectancy damages—the point is simply that the seller's hypothetical losses are different than the buyer's real losses, in the form of the deposit. Leaving aside any reliance/mitigation damages that a seller incurs, it seems that in forfeiting a deposit, a buyer loses "real" money. Conversely, in being the aggrieved party when a buyer breaches, a seller loses "hypothetical" money.

Perhaps the distinction does not matter since the law does recognize the right of a seller to his expectancy damages. But a dose of realism, again, is helpful. If you asked a person on the street the following question: "Who is worse off? A person who loses $40,000 in cash, or a person who thought they were going to get $40,000 in cash and doesn't?" the answer would likely be the former. An actual loss is worse than a loss of a hypothetical gain.[296] Again, the point is not to challenge the rule that a seller is entitled to the benefit of his bargain, but to illustrate the nature of the different losses that buyers and sellers suffer when a buyer breaches a real estate contract.

[294] *See* RESTATEMENT (SECOND) OF CONTRACTS § 356 (AM. LAW INST. 1981).

[295] L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 56–57 (1936) ("It is obvious that the three 'interests' we have distinguished [restitution, reliance, expectation] do not present equal claims to judicial intervention . . . . It is as a matter of fact no easy thing to explain why the normal rule of contract recovery should be that which measures damages by the value of the promised performance.").

[296] This, of course, ignores the seller's actual monetary losses for the moment and only focuses on the loss of their expectation interest.

F. *Real Estate Transactions Are Largely Consummated by Real Estate Agents Who Are Not Looking Out for Buyers' Best Interests*

Finally, it is worth situating a typical residential real estate transaction in context. When buyers sign an agreement to purchase real estate, they are probably overwhelmed, anxious, and worried.[297] This will likely be the biggest purchase of their life.[298] They have agreed to hand over a huge sum of money as a deposit because their real estate agent told them to. They are concerned about obtaining financing, whether they can afford the house, and the potential for an inspector to discover major problems like mold, radon, or termites. The list is endless. One of the last things on their minds is trying to decipher the meaning of a dense legal document and its potential implications.

The reality is that buyers are rarely represented by lawyers at the contracting stage of a real estate purchase.[299] Standard forms are supplied,[300] and filled in,[301] by real estate agents, not lawyers.[302] In an article written by Professor Braunstein, he posits that "the real estate agent is the dominant player in the residential real estate transaction in almost all parts of the United

[297] *See* Zoya Gervis, *Buying a Home Is an Anxiety-Inducing Nightmare: Study*, N.Y. POST (Aug. 6, 2018), https://nypost.com/2018/08/06/buying-a-home-is-an-anxiety-inducing-nightmare-study/ [https://perma.cc/46JW-R7VC].

[298] N.J. DEP'T OF BANKING & INS., EVERYTHING YOU WANT TO KNOW ABOUT BUYING A HOME, https://www.state.nj.us/dobi/division_consumers/pdf/buyingahome.pdf [https://perma.cc/5XXG-N7QQ]; Michael Braunstein & Hazel Genn, *Odd Man Out: Preliminary Findings Concerning the Diminishing Role of Lawyers in the Home-Buying Process*, 52 OHIO ST. L.J. 469, 470 n.4 (1991) ("Ninety-five per cent of the 132 Columbus home buyers surveyed said that their house was the most valuable asset they owned and 64.5% said that they bought the most expensive house they could afford."); HERRING BANK, A GUIDE FOR FIRST TIME HOME BUYERS, https://www.herringbank.com/a-guide-for-first-time-home-buyers/ [https://perma.cc/DUN5-RJV9] ("Most people rank their home purchase as their number one most important financial decision . . . Buying a house is literally the investment of a lifetime.").

[299] Braunstein, *supra* note 39, at 260–61.

[300] Oftentimes, these standard forms fail to offer adequate protection to buyers. *See* Decker v. Strom & Strom Realtors, 695 So. 2d 803, 803 (Fla. Dist. Ct. App. 1997).

[301] Gustafson v. V.C. Taylor & Sons, 35 N.E.2d 435, 437 (Ohio 1941) (describing the blanks that get filled in as "the supplying of simple, factual material such as the date, the price, the name of the purchaser, the location of the property, the date of giving possession and the duration of the offer requires ordinary intelligence rather than the skill peculiar to one trained and experienced in the law").

[302] Braunstein, *supra* note 39, at 261–62 ("Respondents indicated that in 35 of the 40 states responding, the real estate agent typically negotiates and drafts the contract of purchase and sale without the aid or assistance of an attorney. In these states, the real estate agent prepares the contract and other necessary documentation on standardized forms. Usually, these forms have been approved by the local board of realtors, the local bar association or both. In these states, attorney involvement is often limited to transactions in which no realtor is involved or transactions that are unusually complicated, such as those involving contract for deed or seller financing.").

States . . . [and] most of the work of residential conveyancing is controlled or performed by real estate agents."[303]

Contracts to purchase real estate are standard form contracts which are usually prepared or endorsed by the local association of realtors.[304] They are essentially "one size fits all."[305] They contain blanks for key terms such as address, price, deposit amount, and closing date.[306] The rest of the contract is largely boilerplate.[307] Sometimes these pre-packaged forms work to the detriment of the buyers, who may not realize that the contract does not provide the protection they thought. For instance, in *Decker v. Strom & Strom Realtors, Inc.*, the court ordered the buyers to forfeit their $28,900 escrow deposit, noting that "the mortgage contingency clause in the Sarasota Board of Realtors and Sarasota County Bar Association standard real estate contract is the source of this unfortunate result," and "[i]f the parties had used the Florida Bar standard contract, the [buyers] could have specified a maximum interest rate and avoided this litigation."[308]

Typically, it is the seller that supplies the standard purchase and sale agreement to the buyer and the buyer's agent.[309] One Massachusetts law firm blog refers to the standard form purchase and sale agreement in that state as "anything but 'standard.'"[310] It specifically notes that the form "provides several hidden advantages to a Seller."[311] A buyer probably does not know that this purchase and sale agreement is seller-friendly.[312] A buyer's agent probably *does* know that this agreement is tilted in favor of the seller—but probably does not

[303] *Id.* at 260.

[304] *Id.* at 261.

[305] *See id.* at 253.

[306] *See id.* at 253–55 (discussing a trend towards fill-in-the-blank standard forms); *see, e.g.*, CAL. ASS'N OF REALTORS, CALIFORNIA RESIDENTIAL PURCHASE AGREEMENT AND JOINT ESCROW INSTRUCTIONS 8 (Dec. 2015).

[307] *See* Braunstein, *supra* note 39, at 253.

[308] Decker v. Strom & Strom Realtors, 695 So. 2d 803, 803 (Fla. Dist. Ct. App. 1997).

[309] *See, e.g.*, Comment from Ellen D'Ambr, *Home Selling: Who Writes Up the Purchase and Sales Agreement? Our Attorney or Our Realtor?*, TRULIA (Mar. 24, 2015), https://www.trulia.com/voices/Home_Selling/Who_writes_up_the_purchase_and_sales_agreement_Ou-315513 [https://perma.cc/BF25-RLUX]; Jeanne Sager, *Who Draws Up the Purchase Agreement for a Home that Is for Sale by Owner?*, REALTOR.COM (Sept. 26, 2017), https://www.realtor.com/advice/buy/if-the-seller-doesnt-have-a-realtor-who-is-responsible-for-drawing-up-the-purchase-agreement/ [https://perma.cc/UE2H-WBE7].

[310] Richard D. Vetstein, *Massachusetts Purchase and Sale Agreement Basics*, MASS. REAL EST. L. BLOG, http://massrealestatelawblog.com/frequently-asked-questions/purchase-sale-agreement-basics/ [https://perma.cc/NBF9-JRC5].

[311] *Id.*

[312] Nancy Park, *Pre-Printed Contracts—To Use . . . Or Not*, Press Enterprise (Aug. 17, 2019), https://www.pe.com/2019/08/17/pre-printed-contracts-to-use-or-not/ [https://perma.cc/E7AP-8GLY] ("[T]he form user should beware that the party who drafted it may have included clauses favorable to that party. For instance, a broker-drafted form may include payment protections for [the broker], even though a buyer and seller are the intended actual signing parties to the contract.").

much care, since his interest is in simply getting the deal done.[313] In contrasting the role of a real estate agent with a lawyer,[314] Professor Braunstein observes, "The broker is interested only in consummating a sale and getting her commission, while the lawyer is paid whether or not the sale is consummated. Thus the lawyer, unlike the broker, is not tempted to sacrifice the parties' interests to close the deal."[315] Professor Pogrund Stark argues that it is "in the broker's interest to not have an attorney review and approve the contract because the attorney may raise points that delay the deal or even cause the deal to not go through."[316] As such, a real estate agent may be unlikely to truly represent a buyer's best interests, including pointing out terms that may be problematic or disadvantageous.[317]

[313] *See* Braunstein, *supra* note 39, at 243–44.

[314] To the extent that lawyers are involved in the process, it tends to be later, in preparation for closing. Braunstein, *supra* note 39, at 264–65 ("[L]awyer involvement after the purchase contract is executed is greater than in the pre-contract stage. Still, in most cases attorneys are not involved in readying the transaction for closing and frequently are not present at the closing. In only eight states of the forty states reporting is it customary for either the buyer's or the seller's attorney to ready the transaction for closing. In the rest of the states the preparation of the closing documentation and the closing itself are handled by the real estate agent, the title insurance company, a corporate closing company, an escrow agency, or some combination of them."). Even if lawyers are involved, survey results suggest that they do not impart a significant benefit to their buyer clients. Braunstein & Genn, *supra* note 298, at 479–80 ("Most importantly, preliminary survey results indicate that increased lawyer involvement might not have any beneficial effect for the following reasons: (1) Purchasers who use lawyers are no better informed than those who do not. (2) Purchasers who use lawyers are no more satisfied with the purchase transaction. In fact, in the Columbus sample, the general satisfaction level of those who did not use a lawyer was greater than for those who did. (3) Purchasers who use lawyers are just as likely to find after signing the contract that it contains matters which had not been explained to them or which they did not expect . . . . (4) Purchasers who used lawyers were no less likely to avoid disputes than those who did not.").

[315] Braunstein, *supra* note 39, at 243–44. The amount of commissions paid to real estate agents is staggering. *See, e.g.*, *Table 5.4.5: Private Fixed Investment in Structures by Type*, BUREAU ECON. ANALYSIS (July 30, 2019), https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&nipa_table_list=151 [https://perma.cc/D5X6-FKNC] (showing the total commissions paid by home sellers and buyers as $162.5 billion in 2018).

[316] Stark et al., *supra* note 261, at 841 n.264.

[317] A buyer's broker may not necessarily even be interested in whether the transaction closes, since they may be owed their commission even if the buyer breaches the contract. *See* Chan v. Tsang, 3 Cal. Rptr. 2d 14, 20–21 (Ct. App. 1991) ("Buyer solicited Broker's services, Broker obtained property for Buyer, Buyer entered into an agreement to purchase but then defaulted without justification. Consequently, Buyer breached his implied promise to complete the transaction, and therefore Broker is entitled to recover from Buyer the commission he would have earned had Buyer performed. The amount of that commission is 2½ percent of the $4 million purchase price, or $100,000.").

Buyers often believe, however, that their real estate agent is there to "protect" them.[318] In a study conducted by Professor Braunstein, he noted that many buyers who opted not to involve a lawyer did so because they relied instead on their agent.[319] But real estate agents are not lawyers, and are not in any position to provide legal advice.[320] The most an agent can do, and is legally authorized to do, is to help fill in blanks on standard forms.[321] This is an entirely ministerial task, one that the buyer could easily have done himself. Moreover, a so-called "buyer's agent" is actually considered a sub-agent of the listing broker, and accordingly, is not there to protect a buyer's interests. The sub-agent "works for a listing broker-salesperson in the sale of a property. The sub-agent represents the seller, and therefore, works with the buyer, but not *for* the buyer. The sub-agent owes fiduciary duties to the listing broker and to the seller."[322]

The fact that the most expensive purchase of a buyer's life is governed by a largely non-negotiated, seller-prepared contract of adhesion is troubling. The bottom line is that buyers are often navigating a very complicated transaction, consisting of multiple moving pieces, with little assistance other than that provided by a real estate agent, someone who has a vested interest in the outcome, and who owes his loyalty to the seller. So, any assumptions that a buyer fully appreciates all these moving pieces should be taken with a grain of salt.

[318] *See* Braunstein & Genn, *supra* note 298, at 477 ("[S]ome buyers rely extensively on real estate agents to protect their interests without knowing that the agent's primary loyalty is to the seller, and not to the buyer.").

[319] *Id*. at 472 ("[M]any people said they did not need a lawyer because they relied on the agent.").

[320] Additionally, many brokers disclaim liability for incomplete or inaccurate advice they give to buyers. *See, e.g.*, KELLER WILLIAMS REALTY, EXCLUSIVE BUYER BROKER AGREEMENT 1 (2009), https://images.kw.com/docs/1/2/0/120860/1236032395865_Buyer_Brokerage_Agreement.pdf [https://perma.cc/VT22-XK44]; *see also* Christy Bieber, *9 Things Real Estate Agents Don't Want You to Know*, MOTLEY FOOL (Nov. 22, 2017), https://www.fool.com/mortgages/2017/11/22/9-things-real-estate-agents-dont-want-you-to-know.aspx [https://perma.cc/2MMC-XGTU] ("If your contract is coming from your broker, look carefully for a disclaimer of promises. This disclaimer may state that you're going through with the sale as a buyer without any reliance on verbal statements from real estate agents or sellers. Of course, in reality, you have little else to rely on.").

[321] *See* Braunstein, *supra* note 39, at 255 (stating that most courts have found filling in blanks on standard forms requires only "ordinary intelligence").

[322] *Types of Agency-Brokerage Relationship with Consumers*, REALTOR MAG., https://magazine.realtor/tool-kit/buyer-representation/article/2019/01/types-of-agency-brokerage-relationships-with-consumers [https://perma.cc/D54Q-P8Y2] (emphasis added). Note that in recent years, a few courts have assigned to the "selling broker" (i.e., the buyer's agent) some duties that are owed to the purchaser. Carol C. Honigberg, *Courts Examine Brokers' Fiduciary Duties*, CCIM INST., https://www.ccim.com/cire-magazine/articles/courts-examine-brokers-fiduciary-duties/?gmSsoPc=1 [https://perma.cc/K2TF-KUZB].

VI. THE NEED FOR A NEW APPROACH

The law is heavily tilted in favor of a seller of real estate.[323] In the vast majority of cases, the law allows the seller to retain the buyer's deposit in the event of a breach. This deposit can be a fairly small percentage of the purchase price (2% or 3%) or a very large percentage of the purchase price (15% or 20%). The number is usually sizeable. To be sure, there are cases ordering a return of the deposit to the buyer to avoid unjust enrichment. But, these cases are fairly few and far between.[324]

Courts justify the forfeiture of the buyer's deposit in a variety of ways: by saying that the buyer understood what he was agreeing to, by invoking hypothetical and prospective harm, by inflating the seller's actual harm, and by extolling the virtues of liquidated damages clauses generally. The reality, however, is that the current practice of validating the forfeiture of almost any deposit means that buyers suffer very real losses, while sellers often walk away with a huge windfall. That is not to say that sellers do not suffer harm when a buyer breaches a contract, but that harm is rarely anywhere close to amount of the buyer's deposit. Is there not a better way? Should the law not provide some protection for buyers who are likely making the biggest purchase of their lives?

It seems strange that the law would afford protection to buyers and consumers in so many facets of life—but not this one. For instance, many states regulate layaway sales, so that a buyer does not end up penalized for breaching a contract to purchase a product. In Ohio, for instance, the law states that, "[t]he amount of the liquidated damages to which the seller is entitled shall not exceed the lesser of twenty-five dollars or ten per cent of the value of specific goods subject to the layaway arrangement."[325] Other states have statutes that are similar.[326] What these all have in common is that they regulate the maximum

[323] *See, e.g.*, Perroncello v. Donahue, 835 N.E.2d 256, 258–59 (Mass. App. Ct. 2005), *superseded in part by* Perroncello v. Donahue, 859 N.E.2d 827, 833 (Mass. 2007) (ordering a buyer to specifically perform the contract to purchase the property *and* to forfeit a $150,000 deposit). Fortunately, the appellate court saw the absurdity of this holding and reversed. *See* Perroncello v. Donahue, 859 N.E.2d 827, 833 (Mass. 2007) ("To award liquidated damages against the buyer for his failure to close and also specific performance to the seller requiring the buyer to acquire the property by a date certain at the contracted price, would violate the fundamental principles of contract law.").

[324] *See, e.g.*, Jones v. Hryn Dev., Inc., 778 N.E.2d 245, 249 (Ill. App. Ct. 2002) ("In the instant case, the facts are undisputed that defendant sold the property for $22,640 more than the contract price promised to plaintiffs. Defendant incurred $10,892.16 in costs due to plaintiffs' failure to close. Since defendant profited from the sale of the house to the third party, notwithstanding the costs incurred as a result of plaintiffs' breach, defendant incurred no actual damages. Here, the trial court erred by not ordering defendant to return the entire sum of plaintiffs' purchase monies.").

[325] OHIO REV. CODE ANN. § 1317.21 (West 1995).

[326] *See, e.g.*, MD. CODE ANN., COM. LAW § 14-1106(c) (LexisNexis 2013) ("If the buyer defaults under a layaway agreement 8 or more calendar days after the date of its execution, the seller may retain as liquidated damages an amount not to exceed 10 percent of the

amount that a buyer might owe in the event of a breach. They do not permit the buyer and the seller to dictate the terms of the agreement (an arrangement that would always favor the seller). Instead, the law provides some minimum level of protection to the layaway buyer, while recognizing that the seller should also be compensated for the breach.[327]

When it comes to the purchase of real estate, there are laws that are expressly designed to protect the buyer. For instance, there are state disclosure laws that require a seller to disclose any material defects with the property.[328] There are lending laws that require full disclosure of the costs of a mortgage.[329] There are federal laws eliminating kickback fees and referral fees to protect buyers from "unnecessarily high settlement charges caused by certain abusive practices" in real estate closings.[330] Strangely, though, there are no laws in most states regulating deposits.[331] Instead, parties are simply left to their own devices,

layaway price or the total amount paid by the buyer to the date of default, whichever is less.").

[327] Notably, 10% of the purchase price probably does not even come close to a seller's actual damages. Many products are marked up by at least 50−60%. When a buyer breaches, the seller loses the profit it would have made from that sale. *See* R.E. Davis Chem. Corp. v. Diasonics, Inc., 826 F.2d 678, 683 (7th Cir. 1987) ("According to a number of courts and commentators, if the seller would have made the sale represented by the resale whether or not the breach occurred, damages measured by the difference between the contract price and market price cannot put the lost volume seller in as good a position as it would have been in had the buyer performed. The breach effectively cost the seller a 'profit,' and the seller can only be made whole by awarding it damages in the amount of its 'lost profit.'").

[328] Florrie Young Roberts, *Let the Seller Beware: Disclosures, Disclaimers, and "As Is" Clauses*, 31 REAL EST. L.J. 303, 305 (2003).

[329] *See, e.g.*, Truth in Lending Act, 15 U.S.C. § 1601 (2012) (act requires lenders provide specific information to buyers about use of credit and provides a right to cancel transactions in some circumstances). There are questions about the efficacy of these disclosure laws. *See* Jessica M. Choplin & Debra Pogrund Stark, *Doomed to Fail: A Psychological Analysis of Mortgage Disclosures and Policy Implications*, 32 BANKING & FIN. SERVS. POL'Y REP. 11, 13 (2013) (describing three problems that consumers face in reviewing home loan disclosure documents: "(i) consumers do not know where to look when they review disclosure documents, (ii) even if consumers know where to look, they often have difficulties remembering where to look, (iii) even if consumers discover problematic terms, the terms can often be explained away"); Debra Pogrund Stark et al., *Ineffective in Any Form: How Confirmation Bias and Distractions Undermine Improved Home-Loan Disclosures*, 122 YALE L.J. ONLINE 377, 379 (2013) (noting that consumers suffer from confirmation biases, "i.e., cognitive biases wherein individuals skim through documents seeking to confirm the truth of what they are told (e.g., "Your loan is at 4%") and fail to skim for evidence that a statement is false (e.g., that the loan may start at 4%, but can increase to a rate as high as 8%). These confirmation biases are of particular interest because . . . they . . . cause consumers to miss the critical information that disclosure forms were designed to communicate, thereby undermining Congress's intentions in mandating the use of disclosure forms.").

[330] Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 (2012).

[331] *But see* CAL. CIV. CODE § 1675 (West 2011); OKLA. STAT. ANN. tit. 15, § 215 (West 2013); WASH. REV. CODE ANN. § 64.04.005 (West 2005).

on the (very questionable) theory that the parties are in the best position to guard against potential harm occasioned by a breach.

As discussed above, people make bad decisions. As Professor Rachlinski observes:

> [Human beings] often make poor choices, seizing upon irrelevant considerations to support their decisions even as they ignore important ones. Even choices that seem well-considered are often based on simplistic reasoning processes that are inconsistent with deductive logic. Cognitive psychologists who study judgment and choice contend that these foibles arise because people rely on an imperfect set of heuristics or mental shortcuts, rather than deductive logic to make judgments. These heuristics serve people well in many circumstances, but they also create vulnerability to the predations of advertisers, political spin doctors, trial attorneys, and ordinary con artists.[332]

It is precisely because people are poor decision-makers that they sometimes need to be saved from themselves. In fact, "virtually every scholar who has written on the application of psychological research on judgment and choice to law has concluded that cognitive psychology supports institutional constraint on individual choice."[333] This institutional constraint in the context of residential real estate contracts should come in the form of restrictions on the amount of money that a buyer will be required to forfeit if he breaches.

The time has come for states to regulate deposits in residential real estate transactions by way of statute. Simply tweaking the doctrinal test for liquidated damages (through, for instance, the "second look" approach) is not enough.[334] Even in those jurisdictions with fairly buyer-friendly law on real estate deposits, there is still much confusion in the law and unnecessary litigation.[335] A statutory solution would ensure that parties "know where they stand." Buyers will know that they will likely forfeit x% of the purchase price if they breach the contract

[332] Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165, 1165 (2003) (citations omitted).

[333] *Id.* at 1166.

[334] Although not writing specifically about this issue, Professor Garvin's comments in Larry T. Garvin, *Disproportionality and the Law of Consequential Damages: Default Theory and Cognitive Reality*, 59 OHIO ST. L.J. 339, 360–61 (1998), resonate here:

> Why not simply follow some commentators on disproportionality and leave it to the discretion of the court, doing justice as the court sees fit? One need not share Holmes's oft-expressed distaste for justice to doubt that this enterprise will prove worthwhile. Unconfined, equity becomes what Max Weber referred to as "kadi justice"—unsystematic, often unpredictable results lacking a governing principle. At best, notions like "reasonable" or "equitable" or "unconscionable" may develop set ways over time, thanks to precedent, but they never quite lose their loose structure.

[335] Litigation over the reasonableness of liquidated damages clauses undermines one of the main perceived benefits of such clauses.

to purchase the property. And sellers will know that x% is what they will likely receive in the event of a breach.[336]

Although a statute would provide some scope for party autonomy, it stands to reason that most parties to a real estate transaction will adhere to the presumptively enforceable deposit amount prescribed by statute. This is exactly what has happened in California. California is one of just three states to regulate real estate deposits in residential transactions by statute.[337] The statute provides that a deposit of 3% of the purchase price is presumptively enforceable as a reasonable estimate of liquidated damages.[338] Since the law was enacted in 1977, the vast majority of real estate contracts in California have provided for deposit of 3% (or less) of the purchase price.[339] Most importantly, litigation over deposits in residential real estate transactions in California is almost non-existent. In the forty years since the statute was enacted, there have been just a handful of cases that have been litigated.[340]

A statutory approach is the only way to balance the competing interests at play: the need for party certainty; the prevention of unjust enrichment; the principle of just compensation; and the desire to avoid disproportionate forfeiture. As argued by one commentator:

> Generally, California [law] provides for certainty while still protecting the buyer of residential housing from forfeiting an unreasonably large amount upon his breach. Sections (c) and (d) of the statute do not operate to set conclusive amounts that will be upheld or invalidated. Rather, the sections serve as presumption and burden of proof provisions. When residential property is involved, this flexibility is necessary for the court to retain the ability to "do justice" in the individual case, given that the parties may lack the requisite level of sophistication.[341]

It is recommended that other states undertake a comprehensive examination of relevant law on real estate deposits, reach out to relevant stakeholders, and then begin the process of drafting a Deposit Statute.

[336] Of course, parties do not need to include a liquidated damages provision in a contract for the purchase and sale of real estate. If they do not include a liquidated damages clause, a seller would be entitled to pursue actual damages arising from the breach.

[337] CAL. CIV. CODE § 1675 (West 2011). The other two states are Oklahoma and Washington. OKLA. STAT. ANN. tit. 15, § 215 (West 2013); WASH. REV. CODE ANN. § 64.04.005 (West 2005).

[338] CAL. CIV. CODE § 1675 (West 2011).

[339] *See* CAL. ASS'N OF REALTORS, *supra* note 306, at 8 ("If the Property is a dwelling with no more than four units, one of which Buyer intends to occupy, then the amount retained shall be no more than 3% of the purchase price.").

[340] *See, e.g.*, Kuish v. Smith, 105 Cal. Rptr. 3d 475, 477–78 (Ct. App. 2010) (seller requiring two "non-refundable" deposits); Allen v. Smith, 114 Cal. Rptr. 2d 898, 907 (Ct. App. 2002), *as modified on denial of reh'g* (Jan. 23, 2002) (seller characterizing extra deposit money as "an option").

[341] Coopersmith, *supra* note 16, at 297.

VII. DRAFTING A REAL ESTATE DEPOSIT STATUTE

A. *Scope of the Statute*

First, states must decide on the scope of any deposit statute. That is, what sorts of transactions would the statute apply to? I suggest that it would be preferable to limit the deposit statute to residential real estate transactions—that is, transactions where the buyer is purchasing property for his personal, household use.[342] Buyers in residential real estate transactions are at a particular disadvantage: they often do not fully comprehend what they are agreeing to, they are overwhelmed by what is likely the biggest purchase of their lives, they are relying on a real estate agent to protect their interests, and they fail to adequately anticipate and provide for potential problems.[343] Buyers in commercial real estate transactions, by contrast, tend to be more sophisticated, and, at least in theory, should be able to look out for themselves.

One other scope issue is worth addressing. A number of the deposit cases involve properties where a developer or builder sells property to a buyer that is yet-to-be-built. Typically, a buyer will sign a contract to purchase such a property early on in the construction or pre-construction process. The actual closing will often take place many months—and sometimes years—after the original contract is signed. Contracts for the purchase of these residential units may raise unique concerns.[344] Accordingly, it would make more sense to exempt yet-to-be-built residential construction from the scope of any deposit statute and deal with these sorts of contracts in a more comprehensive manner.[345]

[342] In this respect, it makes sense to follow the lead of California, which has distinguished between contracts for the purchase of residential versus nonresidential property. *See* CAL. CIV. CODE § 1675 (West 2011). The California statute provides:

> (a) As used in this section, "residential property" means real property primarily consisting of a dwelling that meets both of the following requirements:
> (1) The dwelling contains not more than four residential units.
> (2) At the time the contract to purchase and sell the property is made, the buyer intends to occupy the dwelling or one of its units as his or her residence.

Id. An alternative definition can be found in a now-repealed Washington statute which provides that residential property is property "being purchased by the purchaser primarily for the purchaser's personal, family, or household purposes." Law of July 28, 1991, ch. 210, § 1(1)(b), 1991 Wash. Sess. Laws 1082 (repealed 2005). Note that the repealed Washington statute included additional language which would limit the definition to monies *designated* as earnest money and would not include other deposits or payments made by the purchaser. *Id.* § 1(4). For the reasons discussed in Part VII.B, I would not endorse the latter part of this definition.

[343] *See supra* Part V.F.

[344] For instance, the seller/developer will likely be relying on the deposits to finance the development or to obtain credit.

[345] *See, e.g.*, N.J. STAT. ANN. § 12A:2–718 (West 2004).

B. *Payments Subject to the Statute*

The next issue would be to address what constitutes a "deposit" that would be subject to the Deposit Statute. In order to avoid the potential for parties to contract around the statute,[346] the concept of a deposit should be defined broadly. The State of Washington defines an "earnest money deposit," in part, as "any deposit, deposits, payment, or payments of a part of the purchase price for the property, made in the form of cash, check, promissory note, or other things of value for the purpose of binding the purchaser to the agreement."[347] Alternatively, one could avoid the term "deposit" altogether by providing that the statute applies to "[a] provision in a contract to purchase and sell residential property that provides that all or any part of a payment made by the buyer shall [be forfeited] to the seller upon the buyer's failure to complete the purchase of the property."[348] Regardless of the precise way that the statute is drafted, the point is to ensure that courts consider *all sums forfeited* by the buyer in connection with a breach.

The Deposit Statute must also address extension payments, or any other payment made under the contract that is not technically a deposit. Buyers pay a deposit into escrow at the time they enter into the contract to purchase property. As the closing nears, buyer may request an extension of the agreed upon deadlines or an extension of the closing date. Oftentimes, the buyer offers (or the seller demands) additional payments in return for such an extension. Accordingly, a buyer may make a 5% deposit initially, but through extension payments, pay 15% or 20% of the purchase price. The contract will almost

[346] For instance, in Baker v. Heslep, No. 60239–0–I, 2008 WL 176358, at *1 (Wash. Ct. App. Jan. 22, 2008), the contract provided for an initial $10,000 earnest deposit, and an additional $40,000 to be paid approximately 45 days before closing. The court found that the operative statute capping liquidated damages at 5% of the purchase price was inapplicable because only the $10,000 was technically designated as earnest money. *Id.* at *2. The court stated:

> [Buyer] contends the additional $40,000 payment should also be considered earnest money and that the portion of it exceeding five percent of the purchase price should be refunded. [Buyer] is incorrect for two reasons. First, the addendum, drafted by [Buyer], expressly made the $40,000 payment "nonrefundable." We cannot ignore this unambiguous expression of the parties' intent. Second, the payment does not meet the statutory definition of earnest money: "Earnest money deposit" means any deposit, deposits, payment, or payments of a part of the purchase price for the property, made in the form of cash, check, promissory note, or other things of value for the purpose of binding the purchaser to the agreement and *identified in the agreement* as an earnest money deposit, and does not include other deposits or payments made by the purchaser. Unlike the $10,000 payment, which is clearly identified as earnest money in both the printed portion of the contract and in the handwritten addendum, the $40,000 is nowhere designated as earnest money.

Id. (citations omitted).

[347] WASH. REV. CODE ANN. § 64.04.005 (West 2005).

[348] *See, e.g.*, CAL. CIV. CODE § 1675(b) (West 2011) (California approach).

invariably provide that the buyer must forfeit these additional payments in the event of breach.

For instance, in *Wallace Real Estate Investment v. Groves*, the buyer put down a $20,000 earnest money deposit, less than the statutory maximum of 5%.[349] However, he paid $240,000 in extension payments.[350] The court found that *only* the $20,000 constituted a "deposit" within the meaning of the Washington statute.[351] Since the $240,000 in payments were outside the ambit of the statue, the sellers were permitted to keep the full amount of the extension payments, plus the $20,000 earnest money deposit.[352] Additionally, by the time the buyers breached the contract, the property had appreciated several hundred thousands of dollars.[353] This left the sellers with "the windfall of the $260,000.00 in payments from the [buyer] and also left them with the appreciated, developable Property itself, which the [seller] can still sell at a time of their choosing."[354] The court concluded that the buyer's forfeiture of 17% of the contract price, which accounted for the deposit and extension payments, was not excessive.[355]

The question is whether an extension payment—ostensibly a second contract supported by separate consideration—should be included within the purview of the statute.[356] Arguably, it should be, and the total amount forfeited by the buyer should be the relevant reference point. Both an initial deposit and any subsequent extension payments are made in contemplation of the purchase of the property in question. Accordingly, it stands to reason that a court should consider the total of all the payments made in furtherance of the contract, and potentially forfeited, in applying any statute. In this respect, it may be preferable to draft a statute without an explicit definition of a "deposit," but instead to refer more generally to "payments made by a buyer [that] shall [be forfeited]."[357]

[349] Wallace Real Est. Inv. v. Groves, 881 P.2d 1010, 1018 (Wash. 1994).

[350] *Id.* at 1013 ("The sellers then retained the $260,000 in earnest money and extension payments as liquidated damages.").

[351] *See id.* at 1018.

[352] *Id.* at 1018–19.

[353] The appraisal "clearly indicated that the value of the Property had appreciated above the purchase price ($1,520,000) to a value of $1,854,000." Brief of Appellant at 15–16, *Wallace Real Estate Inv.*, 881 P.2d 1010 (No. 61448-2), 1993 WL 13159760, at *15–16.

[354] *Id.* at 33.

[355] *Wallace Real Estate Inv.*, 881 P.2d at 1018.

[356] Extension payments are not the only way that a seller can try to structure a transaction to avoid a liquidated damages analysis. *See, e.g.*, Kuish v. Smith, 105 Cal. Rptr. 3d 475, 477 (Ct. App. 2010) (parties provided for $600,000 non-refundable deposit, which they did not view as a liquidated damages clause); Allen v. Smith, 114 Cal. Rptr. 2d 898, 903 (Ct. App. 2002), *as modified on denial of reh'g* (Jan. 23, 2002) (court accepted buyer's argument that the use of the term "option" in the counteroffer was designed to circumvent statutory liquidated damages provisions and a nonrefundable deposit of $100,000 is an illegal penalty for breach of contract); Coopersmith, *supra* note 16, at 301 ("[A] statute designed to protect a class of persons is utterly useless if parties are free to draft around the protections.").

[357] CAL. CIV. CODE § 1675(b) (West 2011) ("A provision in a contract to purchase and sell residential property that provides that all or any part of a payment made by the buyer

Finally, the statute should only apply to the extent that payments have actually been "made"—i.e., the buyer has parted with the funds. Any provision which simply allows the seller to sue for liquidated damages upon breach would be exempt from the statute.[358]

C. *The Core of the Statute: How Much?*

As discussed, deposits in real estate transactions run the gamut, from 1–2% on the low end, to 15–20% on the high end. What number represents an appropriate middle ground that compensates sellers for prospective losses while also protecting buyers from excessive losses? I would submit that a number on the lower end (2–3%) would adequately balance the interests involved.[359] Accordingly, the Deposit Statute should contain a presumption that any amount equal to, or lower than, (say) 3% would be enforceable against the buyer.

Consider a typical real estate transaction: On Day 1, the buyer agrees to purchase the seller's property for $400,000 with $12,000 down as a deposit (3%). Closing is scheduled for Day 60.[360] The buyer breaches on Day 30. What has the seller lost? The seller has lost the difference between the contract price and the property's value on Day 30. That is, if the value of the property dipped in those 30 days, the seller will have suffered a loss. In reality, real estate values are unlikely to fluctuate significantly in a one-month period. The seller may also have suffered some consequential damages: having to re-list the property, marketing expenses, carrying costs (if the seller is not living there anymore), etc. The seller is not usually that much worse off one month after signing a purchase and sale agreement. Therefore, $12,000 should be more than adequate to cover the seller's losses.

Of course, there are cases that deviate from the norm. It could be that the market crashes in the period between the signing of the purchase and sale agreement and the buyer's breach, meaning that the seller suffered significant expectancy losses.[361] It could be that the seller is relying on the purchase to finance another transaction and, without the full proceeds of the sale, will forfeit his deposit or will have to arrange for an expensive bridge loan.[362] Certainly,

shall [be forfeited] to the seller upon the buyer's failure to complete the purchase of the property . . . .").

[358] Although an argument can be made that forfeiting a 3% deposit is the same as promising to pay 3% of the purchase price in liquidated damages upon breach, the two are different. In the former scenario, the buyer has already surrendered the money, which gives the seller a great deal of leverage. In the latter scenario, the seller would need to sue for breach and prove that the clause is reasonable, and then seek to collect any money judgment.

[359] Any higher than this and, arguably, one would be entering potential penalty territory.

[360] Recall that the majority of real estate transactions close, on average, within sixty days of the original offer. *See* Braunstein, *supra* note 39, at 270.

[361] The longer the time period between the original purchase and sale agreement and the closing, the more likely this is to occur.

[362] The seller can protect himself by making any contract he enters into contingent upon selling his residence. These contracts tend not to be very popular, for obvious reasons. *See,*

these things are possible. But in the run-of-the-mill case involving residential real estate, this parade of horribles rarely plays out.

D. *Rebuttable Presumptions*

Recognizing that not every residential real estate transaction is the same, the Deposit Statute should preserve the ability of the parties to contract around the maximum default deposit amount in exceptional circumstances. If a seller accepts a deposit in excess of the maximum default, then the burden is on him to prove that the deposit is a reasonable forecast of actual harm. The California statute provides a model for how this could be drafted:

> (c) If the amount actually paid pursuant to the liquidated damages provision does not exceed 3 percent of the purchase price, the provision is valid to the extent that payment is actually made unless the buyer establishes that the amount is unreasonable as liquidated damages.
>
> (d) If the amount actually paid pursuant to the liquidated damages provision exceeds 3 percent of the purchase price, the provision is invalid unless the party seeking to uphold the provision establishes that the amount actually paid is reasonable as liquidated damages.[363]

It would be a rare case where a number in excess of the maximum default deposit would pass muster as a reasonable liquidated damages clause.

Given that the presumptions can be displaced by either the buyer or seller, it is necessary to identify specifically *how* a court should assess whether a clause is reasonable or unreasonable as liquidated damages. Accordingly, the Deposit Statute should clearly lay out the elements of the liquidated damages analysis. Importantly, the Deposit Statute should resolve the confusion that has developed over the years in the various prongs of the test. For instance, it should address whether reasonableness is judged prospectively or retrospectively. If a court is empowered to look at actual damage, is it just for the purpose of determining

e.g., Bill Gassett, *Massachusetts Home Sale Contingencies and Right of 1st Refusal*, MASS. REAL EST. NEWS (Apr. 9, 2010), http://massrealestatenews.com/massachusetts-home-sale-contingencies-and-right-of-1st-refusal/ [https://perma.cc/WWZ3-42BH] ("An offer contingent on another property closing means one thing—YOU LOSE CONTROL OF THE PROCESS!!"). However, there are ways to structure the transaction to provide more of an incentive for a party to accept the contingency. *See* Jean Folger, *Home Sale Contingencies for Buyers and Sellers*, INVESTOPEDIA (Feb. 13, 2019), https://www.investopedia.com/articles/personal-finance/111513/home-sale-contingencies-what-buyers-and-sellers-need-know.asp [https://perma.cc/QQS6-LXDY] ("A seller can include a 'kick-out clause' to provide a measure of protection against a home sale contingency. A kick-out clause states that the seller can continue to market the property and accept offers from other buyers. In this case, the seller gives the current buyer a specified amount of time (such as 72 hours) to remove the home sale contingency and continue with the contract. If the buyer does not remove the contingency, the seller can back out of the contract and sell to the new buyer.").

[363] CAL. CIV. CODE § 1675(c)–(d) (West 2011).

whether the *forecast* was reasonable, or for determining whether the *actual number* selected was reasonable? The California statute, for instance, specifically directs courts to consider: "(1) The circumstances existing at the time the contract was made. (2) The price and other terms and circumstances of any subsequent sale or contract to sell and purchase the same property if the sale or contract is made within six months of the buyer's default."[364] Thus, the statute appears to endorse a dual prospective/retrospective approach (though it does not specify how courts are to use the latter).

One final issue should be dealt with in this regard: what happens when a seller accepts a deposit in excess of the statutory maximum and a buyer breaches the contract? Should the entire deposit be held in escrow until the parties resolve the issue, either through litigation or otherwise? It would seem fair to require the escrow agent to return any monies in excess of 3% to the buyer. This is fair for several reasons. First, if the money is held up in an escrow account, this gives a seller a huge upper hand in negotiations over the deposit. The buyer may be desperate to get some money back, and so may agree to an unfair bargain simply because the alternative means waiting months—or years—to get the money back. Second, it would be a rare case where a seller is entitled to keep monies in excess of the statutory maximum, so he will likely have to give at least part of the money back anyway. Third, in normal contract cases, parties do not get security for their damages.[365] Instead, they must sue the breaching party, get an award for damages, and then seek to collect those damages.[366] There is no reason why a seller in a failed real estate transaction should be in a better situation than any other judgment creditor. Accordingly, it would be prudent for the statute to specifically provide that the escrow agent must return to the buyer anything in excess of the statutory maximum.

Additionally, the Deposit Statute should adopt a "no actual harm" rule, whereby a liquidated damages clause is automatically invalidated if a seller cannot show any actual monetary harm, making the retention of the deposit a complete windfall.[367] Only damages that can be monetized should be considered in determining whether the seller suffered actual harm—things like inconvenience, delay, and added effort or stress should not be permitted to figure into the calculus. The Deposit Statute could provide something to the effect of: "If the buyer is able to show that the seller did not suffer any monetary

[364] *Id.* § 1675(e)(1)–(2).

[365] *See* 22 AM. JUR. 2D *Damages* § 507 (2013).

[366] *See id.*

[367] The Governor of California, in fact, vetoed the original version of the California bill regulating real estate deposits, stating, "In cases where the value of the real property is expected to increase, and the seller will suffer no actual damages, automatic retention by the seller of any amount deposited by the defaulting buyer is unreasonable." CAL. LEG., JOINT RECESS J. NO. 23, 1975–76 Reg. Sess., at 21805 (1976). The section was then amended to allow a court to take into account both circumstances existing at the time the contract was made, as well as any actual sale of the property within six months of the breach. *See* 1977 Cal. Stat. 718.

loss as a result of the breach, the buyer is entitled to a refund of the entire deposit amount."

E. *Election Clauses*

The Deposit Statute must also address election clauses: clauses where a seller retains the ability to elect between liquidated damages and actual damages. As discussed in Part III, many courts have invalidated such clauses because the inclusion of an option to pursue actual damages is said to negate an intention to liquidate damages. An election clause is essentially a "no lose" proposition for a seller. That is, the seller is guaranteed a minimum amount of recovery in the form of the deposit; if that is not enough, the seller can go after the buyer for additional damages. From the perspective of the buyer, however, this sort of clause is nonsensical. The main reason that a buyer would agree to any sort of deposit/liquidated damages provision is to cap total possible exposure. With an election clause, exposure is not only unlimited—but the buyer also agrees to automatically forfeit a large sum of money irrespective of loss in the event that he breaches.

Any sort of statute must prohibit the seller from being able to elect actual damages in lieu of liquidated damages if a buyer breaches a contract to purchase real estate. The problem, however, is that clauses cannot simply be considered void, since this could penalize a breaching buyer for a clause that the seller inserted. Consider the following scenario: The buyer and seller enter into a contract whereby the seller retains the right to pursue actual damages, or hold on to the buyer's 3% deposit ($30,000) in the event of a breach. Assume that buyer breaches a contract and the seller resells the property for $50,000 less than the buyer was going to pay. Assume further that there are no consequential damages. In this scenario, the seller has suffered $50,000 in damages, and will want to pursue actual damages. If an election clause is invalidated, this should mean that the entire clause fails (i.e., both the liquidated damages portion and the right to pursue damages). This is because the very presence of a clause that gives the seller the option to seek damages in court evinces an intention *not to liquidate* damages in advance. If the entire clause is struck, the seller is left to pursue whatever regular remedies he has available at law. In short, the seller may *benefit* from a court invalidating a liquidated damages clause in these circumstances.

The best statutory solution would be one that provided that, if a seller purports to retain the ability to elect actual damages in lieu of liquidated damages, then the election will actually be made by the buyer. That is, a seller will be entitled to liquidated damages or actual damages, whichever is *less*. If the liquidated damages amount is less, this would not preclude the buyer from arguing that the clause nonetheless operates as a penalty. To follow through on the above example, if the seller suffered $50,000 in actual damages but the liquidated damages clause provided for a deposit in the amount of $30,000 to be forfeited, then the seller would be limited to $30,000. Further, since $30,000

is 3% of the purchase price, this would be presumptively enforceable. However, the buyer would still be able to argue that the amount is a penalty (which may be difficult, if actual harm is in the range of $50,000).[368]

F. *Attorneys' Fees*

Because many standard contracts are seller-friendly, it would not be particularly surprising to see a provision providing that a seller is entitled to attorneys' fees in the event of litigation over a breach of contract. The Deposit Statute should address the possibility that only one of the parties (i.e., the seller) is contractually entitled to attorneys' fees, and provide that if the parties agree that one side will be entitled to attorneys' fees, this will be interpreted so that the prevailing party will be entitled to attorneys' fees, even if not specifically provided for in the agreement.

[368] There is one other "election" issue that the statute may want to address—whether the seller is permitted to seek specific performance. Many contracts for the purchase of residential real estate provide that the seller (or the buyer, for that matter) can pursue any and all remedies at all, including an award of specific performance. Courts usually do not award specific performance to an aggrieved seller after a buyer fails to complete a purchase of real estate. For starters, specific performance is a remedy that is usually reserved for scenarios where there is no adequate remedy at law. In the case of a real estate *sale* (as opposed to a *purchase*), money damages are usually an adequate remedy. That is, a seller of real estate is interested in the proceeds of sale—they have no particular interest in who purchases the property, just that the property is purchased. Second, in many cases, buyers will literally be unable to purchase the property, making specific performance impossible. Overall, it does not appear problematic to allow the seller to retain the ability to seek specific performance, but it may be an illusory remedy in many cases. *See* S.F. Distribution Ctr. v. Stonemason Partners, 183 So. 3d 391, 394 (Fla. Dist. Ct. App. 2014) ("A suit for specific performance seeks equitable relief that requires the breaching party to perform its obligations under the agreement, and is not . . . to be considered the simple equivalent of a claim for damages."). It is critical, however, that courts appreciate that if a seller elects to seek specific performance, he is not also permitted to keep the deposit. *See* Perroncello v. Donahue, 859 N.E.2d 827, 829–33 (Mass. 2007) (reversing lower court, which had ordered specific performance of contract to purchase a property for $2,250,000 *and* permitted the seller to retain deposit of $150,000). For the view that a seller should not be permitted to seek specific performance in the face of a liquidated damages clause, see Coopersmith, *supra* note 16, at 302 ("If the seller has the choice of either retaining the earnest money as liquidated damages or suing for specific performance, the concept of liquidated damages as a form of risk allocation is destroyed. Upon a breach by the buyer, the seller would simply elect the more lucrative alternative. Provided that the difference between the contract price and the market price is greater than the liquidated sum, the seller would elect the specific performance remedy. This analysis highlights a point that the courts have ignored: economically, there is very little substantive difference between the remedies of specific performance and actual damages.").

G. *Notice to Buyer of Consequences of Default*

Most purchase and sale agreements do not clearly spell out what will happen if the buyer defaults.[369] Perhaps it is a safe assumption that "buyers just know this." But, it would be helpful if the Deposit Statute required that the consequences of breach be clearly and conspicuously spelled out.

First, the Deposit Statute should require that the consequences of a buyer's breach with respect to forfeiture of the deposit be laid out in plain English in the purchase and sale agreement.[370] An older version of the Washington State deposit statute implemented this requirement through the following language:

> The agreement [must] include[] an express provision in substantially the following form: 'In the event the purchaser fails, without legal excuse, to complete the purchase of the property, the earnest money deposit made by the purchaser shall be forfeited to the seller as the sole and exclusive remedy available to the seller for such failure.'[371]

Plain language is just part of the equation. The Deposit Statute must strive to ensure that a buyer actually *sees* this provision. Accordingly, the Deposit Statute could require that this language (or substantially similar language) appear on the first page of a purchase and sale agreement. Additionally, the statute could prescribe certain font size requirements, and/or means of textual emphasis, such as bolding, highlighting or underlining. The current California deposit statute contains the following requirements aimed at providing notice to buyers of the potential forfeiture of their deposit:

> § 1677. Requirements; validity of contract provisions
>
> A provision in a contract to purchase and sell real property liquidating the damages to the seller if the buyer fails to complete the purchase of the property is invalid unless: . . . (b) If the provision is included in a printed contract, it is set out either in at least 10-point bold type or in contrasting red print in at least eight-point bold type.[372]

[369] *See supra* Part V.B.

[370] The California legislation does not mandate that the provision be spelled out in plain English. One Assemblyman commented on this omission prior to the bill being enacted: "[T]he bill does not specify any exact wording which must be used. A liquidated damage provision, if drafted in technical legal language, will not be understandable by most consumers, and the warning provided by bold or contrasting type will have little meaning." *Hearing on A.B. 570 Before the S. Comm. on the Judiciary*, 1977 Cal. Leg., Reg. Sess. 4 (1977) [on file with the author].

[371] Law of June 28, 1991, ch. 210, § 1(a)(ii), 1991 Wash. Sess. Laws, at 1082 (repealed 2005).

[372] CAL. CIV. CODE § 1677 (West 2011). The previous Washington statute provided, "(b) If the real estate which is the subject of the agreement is being purchased by the purchaser primarily for the purchaser's personal, family, or household purposes, then the agreement

Further, the California statute provides that the liquidated damages clause is not enforceable unless it "is separately signed or initialed by each party to the contract."[373] Again, the Deposit Statute should ensure that this provision does not inadvertently work to the detriment of the buyer. One can imagine a scenario where one party (either mistakenly or deliberately) fails to sign the liquidated damages clause. This would invalidate the liquidated damages clause,[374] but the seller would be able to pursue actual damages. If actual damages were higher than the deposit, then this provision would potentially penalize a buyer for something that the seller failed to do (i.e., sign the clause). Instead, much like the election scenario described above, the failure of one or both parties to sign should provide the *buyer*—and only the buyer—with the ability to void the clause. In other words, the clause should be voidable at the option of the buyer.[375] So, if the seller's actual damages are less than the deposit amount, the buyer would choose to void the liquidated damages clause. Conversely, if the seller's actual damages are higher than the deposit amount, the buyer would not void the liquidated damages clause.

H. *Putting This All Together: A Draft Deposit Statute*

Based on the above, a Deposit Statute could look like the following:

> §1. THIS ACT SHALL APPLY TO RESIDENTIAL PROPERTY THAT IS BEING PURCHASED BY THE PURCHASER PRIMARILY FOR THE PURCHASER'S PERSONAL, FAMILY, OR HOUSEHOLD PURPOSES. NOTWITHSTANDING THE ABOVE, THIS ACT SHALL NOT APPLY TO RESIDENTIAL PROPERTY THAT HAS NOT YET BEEN SUBSTANTIALLY CONSTRUCTED AS OF THE DATE OF THE PURCHASE AND SALE AGREEMENT.

provision required by (a)(ii) of this subsection must be: (i) In typeface no smaller than other text provisions of the agreement . . . ." Law of June 28, 1991, at 1082.

[373] CAL. CIV. CODE § 1677(a) (West 2011).

[374] "A provision in a contract to purchase and sell real property liquidating the damages to the seller if the buyer fails to complete the purchase of the property *is invalid* unless: (a) The provision is separately signed or initialed by each party to the contract." *Id.* § 1677 (emphasis added).

[375] California courts have recognized the ambiguity in drafting and, accordingly, have read the word "invalid" in the statute to mean "voidable at the option of the buyer." *See* Guthman v. Moss, 198 Cal. Rptr. 54, 60–61 (Ct. App. 1984) ("Thus, failure to comply with the formalities, precludes a seller from enforcing the contract pursuant to section 2983, but a buyer has the right to enforce the contract or rescind it. (§ 2983.1.) Therefore, notwithstanding the requirement of seller's signature, we conclude that section 1675 et seq. were designed solely for the protection of the buyer. We therefore hold that section 1677 gives the buyer the option of either enforcing the agreement or voiding it when the statutory formalities are not satisfied. However, since sellers are not members of that class sought to be protected by the statute, they are precluded from voiding the clause.").

§2. (1) A PROVISION IN A CONTRACT TO PURCHASE AND SELL RESIDENTIAL PROPERTY THAT PROVIDES THAT ALL OR ANY PART OF A PAYMENT MADE BY THE BUYER SHALL BE FORFEITED TO THE SELLER UPON THE BUYER'S FAILURE TO COMPLETE THE PURCHASE OF THE PROPERTY ("LIQUIDATED DAMAGES CLAUSE"):

(A) SHALL BE PRESUMPTIVELY ENFORCEABLE IF THE AMOUNT DOES NOT EXCEED 3 PERCENT OF THE PURCHASE PRICE, UNLESS THE SELLER ESTABLISHES THAT THE AMOUNT IS REASONABLE AS A MEASURE OF LIQUIDATED DAMAGES.

(B) SHALL BE PRESUMPTIVELY UNENFORCEABLE IF THE AMOUNT EXCEEDS 3 PERCENT OF THE PURCHASE PRICE, UNLESS THE SELLER ESTABLISHES THAT THE AMOUNT IS REASONABLE AS A MEASURE OF LIQUIDATED DAMAGES.

(2) WHERE THE AMOUNT ACTUALLY PAID BY A BUYER PURSUANT TO A LIQUIDATED DAMAGES CLAUSE IS LESS THAN THE AMOUNT PROVIDED FOR IN THE CONTRACT, THE LIQUIDATED DAMAGES PROVISION WILL BE READ AS PROVIDING FOR LIQUIDATED DAMAGES IN THIS LESSER AMOUNT.

(3) WHERE THE BUYER HAD NOT PAID ANY MONEY PURSUANT TO A LIQUIDATED DAMAGES CLAUSE, THIS ACT SHALL NOT APPLY.

§3. (1) FOR THE PURPOSES OF SUBDIVISIONS §2.(1), THE REASONABLENESS OF AN AMOUNT ACTUALLY PAID AS LIQUIDATED DAMAGES SHALL BE DETERMINED BY TAKING INTO ACCOUNT BOTH OF THE FOLLOWING:

(A) CIRCUMSTANCES EXISTING AT THE TIME THE CONTRACT WAS MADE THAT THE PARTIES WERE AWARE OF OR SHOULD HAVE BEEN AWARE OF, AND;

(B) CIRCUMSTANCES EXISTING AFTER THE BREACH, INCLUDING ANY SUBSEQUENT SALE OR CONTRACT TO SELL AND PURCHASE THE SAME PROPERTY.

(2) IF THE BUYER CAN SHOW THAT THE SELLER SUFFERED NO MONETARY DAMAGES AS A RESULT OF THE BUYER'S BREACH, THE SELLER MUST REFUND THE ENTIRETY OF THE BUYER'S DEPOSIT.

§4. A CLAUSE WHICH PURPORTS TO ALLOW THE SELLER THE RIGHT TO ELECT TO PURSUE MONETARY REMEDIES IN LIEU OF, OR IN ADDITION TO, LIQUIDATED DAMAGES SHALL RELEGATE THE SELLER TO ACTUAL

DAMAGES OR THE LIQUIDATED DAMAGES DEPOSIT, WHICHEVER IS LOWER. NOTWITHSTANDING THE ABOVE, THE SELLER MAY PROVIDE, BY CONTRACT, THAT THE SELLER IS ENTITLED TO SEEK SPECIFIC PERFORMANCE.

§5. ANY PROVISION PROVIDING FOR ATTORNEY'S FEES SHALL BE INTERPRETED TO AUTHORIZE THE AWARD OF ATTORNEYS' FEES TO THE PREVAILING PARTY, REGARDLESS OF LANGUAGE IN THE CONTRACT THAT WOULD LIMIT THE AWARD OF ATTORNEYS' FEES TO ONE PARTY ONLY.

§6. (1) A LIQUIDATED DAMAGES CLAUSE IN A WRITTEN CONTRACT TO PURCHASE AND SELL RESIDENTIAL PROPERTY MUST BE:

(A) WRITTEN IN PLAIN ENGLISH, IN SUBSTANTIALLY THE FOLLOWING FORM: "IF THE BUYER FAILS TO COMPLETE THE PURCHASE OF THE PROPERTY, WITHOUT LEGAL EXCUSE, THE EARNEST MONEY DEPOSIT OF [AMOUNT] WILL BE FORFEITED TO THE SELLER."

(B) LOCATED ON THE FIRST SUBSTANTIVE PAGE OF A WRITTEN CONTRACT TO PURCHASE AND SELL RESIDENTIAL PROPERTY.

(C) WRITTEN IN A IN A FONT THAT IS AT LEAST 2-POINTS LARGER THAN THE SURROUNDING TEXT; OR BOLDED, UNDERLINED, OR IN ALL CAPITAL LETTERS.

(D) SEPARATELY SIGNED OR INITIALED BY THE BUYER AND THE SELLER.

(2) A LIQUIDATED DAMAGES CLAUSE THAT DOES NOT SATISFY THE REQUIREMENTS IN §6.(1) SHALL BE VOIDABLE ONLY AT THE OPTION OF THE BUYER.

§7. ANY AMOUNT DEPOSITED BY THE BUYER THAT IS IN EXCESS OF 3% OF THE PURCHASE PRICE SHALL BE RETURNED TO THE BUYER WITHIN 30 DAYS OF THE BUYER BREACHING THE CONTRACT.

A statutory approach, such as the one presented above, is the only way to prevent the free-for-all that currently exists with respect to deposits in residential real estate deposits. With a statute as the backdrop, parties can plan their affairs accordingly, have certainty as to where they stand, and avoid unnecessary (and very expensive) legal battles.

VII. CONCLUSION

Buying a home is usually the biggest expenditure in a person's life. For most buyers, it is an overwhelming and stressful experience. By and large, when buyers sign a contract to purchase real estate and put down a sizeable deposit, they fully expect that they will perform. Sometimes, though, life intervenes—and buyers are not able or willing to complete the purchase. The common understanding is that a buyer who breaches will forfeit his deposit, usually a considerable sum. The time has come to take a closer look at the law that requires a buyer to forfeit huge sums of money in the name of "certainty" and "enforcing the parties' bargains."

The current ad hoc approach to deposits is unsatisfactory, as it tends to validate almost any deposit amount as being reasonable. Courts focus extensively on the inherent uncertainty and unpredictability of the real estate market. They emphasize the considerable damage the seller "could have" suffered, while ignoring the fact that sellers rarely actually suffer this damage. The law is currently heavily tilted in favor of a seller of real estate and must be better calibrated to balance all the interests involved.

The time has come for a statutory approach to deposits in residential real estate transactions. A statutory solution would allow lawmakers to carefully consider the interests at play and provide a backdrop against which real estate contracting would play out. As the title to this Article suggests, the law of deposits in residential real estate is a bit of a fixer upper. But, with some hard work and elbow grease, we can give the law an "extreme makeover."[376]

[376] *See Extreme Makeover: Home Edition*, WIKIPEDIA, https://en.wikipedia.org/wiki/Extreme_Makeover:_Home_Edition [https://perma.cc/ 5WGB-33GE] (detailing the home improvement reality TV show, *Extreme Makeover: Home Edition*).